

# Exhibit 30

**ATTORNEY TO CLIENT  
CORRESPONDENCE**

**FOR CONFIDENTIAL USE ONLY**

**Office of  
The City Attorney  
City of San Diego**

**MEMORANDUM  
MS 59**

**(619) 236-6220**

**DATE:** May 20, 2005  
**TO:** Honorable Mayor and City Council  
**FROM:** City Attorney  
**SUBJECT:** City's Illegal Agreement to Indemnify SDCERS Board Members

---

It is my strong recommendation that the City of San Diego refuse to pay any amount to defend or indemnify San Diego City Employees' Retirement System Board Members. Although the City Council passed a resolution on 18 November 2002, agreeing to provide indemnity for "all past, present and future Members of the Retirement Board," that agreement is void as against public policy, and therefore is unenforceable. This memo will provide the outline of the law as it applies to this matter. A more extensive memo will follow.

California Civil Code section 1668 sets forth the general policy that people should bear the consequences of their actions:

All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law.

California Civil Code sections 2773 and 2774, both enacted in 1872, announce the policy of the State with respect to indemnity agreement. Civil Code 2773 states that it is unlawful to agree to indemnify a person for a future act, if the act is known by the person indemnified to be unlawful. Civil Code 2774 states: "An agreement to indemnify a person against an act already done, is valid, even though the act was known to be wrongful, unless it was a felony."

It is clear from the Minutes of the SDCERS' Retirement Board Minutes of 11 July 2002, and from the facts and circumstances surrounding the offering and acceptance of the indemnity, that the provision of indemnity for the Board Members was part of the quid pro quo for Manager's Proposal II [MP II]. The motion that the Board passed to adopt MP II explicitly states:

...To modify the 97 MP: 1) TO ALLOW THE CITY'S REPAYMENT SCHEDULE TO BE THE DIFFERENCE BETWEEN THE RATE AT THAT TIME AND PUC RATE IF THE 82.3% TRIGGER IS HIT; 2) THAT THIS AMOUNT WOULD BE PHASED IN INCREMENTALLY ON AN ANNUAL BASIS BETWEEN THAT POINT AND 2009; 3) THAT THIS BE BASED ON THE CURRENT ACTUARIAL PROJECTIONS WITH THE CITY TO INCREASE ITS PAYMENT 1.0% PER YEAR; 4) THAT THE CITY WOULD REACH THE PUC RATE IN 2009 AS INCLUDED IN THE 97 MP SUNSENT (sic) LANGUAGE; AND 5) TO FUND \$25 MILLION FOR PURPOSES OF PAYING RETIREE HEALTH CARE BENEFITS. ADDITIONALLY, THIS MOTION DOES NOT INCLUDE LOWERING THE FUNDING FLOOR FROM 82.3% AND IS CONTINGENT UPON A WRITTEN AGREEMENT BETWEEN THE CITY AND RETIREMENT BOARD.

San Diego City Employees' Retirement Board Minutes, 11 July 2002.

The transcript of the 11 July 2002 meeting makes clear what would be included in the "written agreement" referenced in the motion. In the transcript, both Larry Grissom, the Plan Administrator, and Frederick Pierce, Chair of the SDCERS Board, articulate the purpose of the agreement. (Their conversation includes Mr. Garnica, another SDCERS Trustee).

MR. GRISSOM: Are you talking about the indemnification thing?

MR. GARNICA: Yes.

MR. GRISSOM: There was a conversation about indemnification in closed session this morning. I don't know, Mr. Chairman, how far you want to go with that in the light of this motion. But it could be made contingent upon the city's agreement, assurance in writing as to the Board's status in this action and its indemnification growing out of or some language close to that.

\* \* \*

MR. PIERCE: What I think what Ray was referring to that in documenting this agreement, that in addition to the terms outlined in the written manager's proposal, that the agreement would also either in that agreement or in a separate written confirmation that the city would issue a written confirmation that in fact the members of this board are deemed employees for purposes of the city's indemnification policies and that any and all actions taken by this Board, that the city would stand behind that indemnity for purposes of all the Board members.

San Diego City Employees' Retirement Board Meeting Transcript, 11 July 2002, pp. 100 - 101.

On 18 November 2002, the City Council adopted a resolution declaring that:

...[T]he City shall defend, indemnify and hold harmless all past, present and future members of the Retirement Board Against all expenses, judgments, settlements, liability and other amounts actually and reasonably incurred by them in connection with any claim or lawsuit arising from any act or omission in the scope of the performance of their duties as Board Members under the Charter.

It is clear that the offer of indemnification was part of the consideration for MP II. This exchange of unfunded benefits for a reduction in the City's obligation to pay was patently illegal and there is evidence to show that the Board members knew of that illegality. See, *Interim Report Number 2, Regarding Possible Abuse, Illegal Acts or Fraud by City of San Diego Officials*, issued 9 February 2005, by San Diego City Attorney Michael J. Aguirre.

Because the Council agreed to provide indemnity to the Board Members after they had already voted for MP II, Civil Code Section 2774 applies. The agreement to indemnify the Board Members for their act of voting was invalid.

The second issue to be considered is whether the Board Members may have their defense paid for by the City pursuant to the Government Code. Assuming, for the sake of argument, that the Board Members who were City employees should be treated as employees for purposes of their defense, the public policy is stated at Government Code section 995.8. That section cautions that "A public entity is not required to provide for the defense of a criminal action or proceeding..." In fact, the only time the City may provide a defense for a criminal proceeding against an employee or former employee is when specific findings are made, including:

(b) The public entity determines that such defense would be in the best interest of the public entity and that the employee or former employee acted, or failed to act, in good faith, without actual malice and in the apparent interests of the public entity.

Clearly, the requisite findings cannot be made by the City Council.

The City Council must now unwind the transaction by rescinding its agreement to indemnify the Board Members. There is no evidence that the Board Members who voted for MP II believed that they were acting for the greater good of the City. On the contrary, their self interest appeared to be their primary motivation.

By



Michael J. Aguirre  
City Attorney

OFFICE OF  
THE CITY ATTORNEY  
CITY OF SAN DIEGO  
MICHAEL J. AGUIRRE  
CITY ATTORNEY

1200 THIRD AVENUE, SUITE 1620  
SAN DIEGO, CALIFORNIA 92101-4178  
TELEPHONE (619) 533-5800  
FAX (619) 533-5856

May 19, 2005

BOARD OF DIRECTORS  
SAN DIEGO CITY EMPLOYEE RETIREMENT SYSTEM

Dear Board Members:

Effective immediately I am advising you to discontinue any additional payments for legal fees for San Diego City Employee Retirement System ("SDCERS") board members who have been charged with criminal law violations by the People of the State of California. Specifically, SDCERS should stop any payments to criminal counsel for Kathy Lexin, Ron Saathoff, John Torres, Mary Vattimo, Terri Webster and Sharon Wilkinson in light of the criminal charges filed against them by the District Attorney's Office.

A public entity such as SDCERS is not required to pay for criminal defense counsel for board members charged with criminal violations of law. Gov Code § 995.8 provides in this regard as follows:

A public entity is not required to provide for the defense of a criminal action or proceeding (including a proceeding to remove an officer under Sections 3060 to 3073, inclusive, of the Government Code) brought against an employee or former employee, but a public entity may provide for the defense of a criminal action or proceeding (including a proceeding to remove an officer under Sections 3060 to 3073, inclusive, of the Government Code) brought against an employee or former employee if:

- (a) The criminal action or proceeding is brought on account of an act or mission in the scope of his employment as an employee of the public entity;  
and
- (b) The public entity determines that such defense would be in the best interests of the public entity and that the employee or former employee acted, or failed to act, in good faith, without actual malice and in the apparent interests of the public entity.

May 19, 2005

The San Diego City Attorney is of the settled belief that paying for the defense of those charged in the subject criminal complaint would not be in "the best interest" of SDCERS. I urge you to calendar for the SDCERS board's consideration a meeting next week to address this issue.

Sincerely yours,

A handwritten signature in dark ink, appearing to read "Michael J. Aguirre". The signature is fluid and cursive, with a prominent "M" and "A".

Michael J. Aguirre  
City Attorney

MJA:meb

Attachment

## S.D. to continue covering pension board's legal fees

[R,C Edition]

The San Diego Union - Tribune - San Diego, Calif.

Author: Craig Gustafson

Date: Apr 19, 2006

Section: LOCAL

Text Word Count: 658

---

### Document Text

---

For the second time in as many months, the San Diego City Council failed to rescind a 2002 decision to pay the legal bills of pension board members -- even though that's what Mayor Jerry Sanders and City Attorney Michael Aguirre wanted done.

The council split 4-4 yesterday on whether it should uphold the 4- year-old promise that critics say gives pension board members a "blanket indemnification" no matter what actions they take. The council needed five votes to repeal the decision.

If it had been approved, the council still would have had the authority to pay for legal fees on a case-by-case basis.

The split could cost the city millions of dollars.

Six former trustees have been charged with conflict-of-interest violations in Superior Court; three also face federal criminal charges.

By one attorney's estimate, the legal defense of just one trustee could cost \$1 million. The city is on the hook to pay for each.

The council indemnified current and future pension board members in November 2002 -- the same month the board approved a plan to allow the city to delay paying millions of dollars in benefit contributions to the pension system.

Critics, including Aguirre, have accused city officials of increasing benefits in labor talks contingent on the pension board approving the underfunding plan. They also argue that the board members -- all current and former city employees -- benefited financially from their votes, breaching their duties as trustees.

The pension system now has a deficit of \$1.43 billion. The Securities and Exchange Commission and the U.S. Attorney's Office have been investigating the city's handling of the fund for more than two years.

Council members Donna Frye and Brian Maienschein approved the indemnification in 2002 but adamantly opposed it yesterday.

"It does not seem reasonable that the public or the city should be responsible to provide a blanket indemnification that indemnifies them against any actions they may take and does not give us a choice," Frye said. "That doesn't make sense. That is not in the best interest of the public."

The other two who voted yesterday to rescind paying the legal fees were Kevin Faulconer and Ben Hueso.

Councilman Tony Young, who along with Faulconer and Hueso did not participate in the 2002 vote, said the city shouldn't back away from its responsibility.

"If you make a promise or a contract or an agreement, then you stand by it," he said. "I don't believe in changing the rules in the middle of the game."

Young also voted against the proposal last month when the council failed on a 4-1 vote to rescind the indemnification, with three council members -- Toni Atkins, Jim Madaffer and Scott Peters -- absent. All three voted against it yesterday, saying they worried about further legal entanglements if pension board members sue to recover legal costs.

Madaffer recommended a new resolution that would halt any future indemnification of pension board members to make it "very clear that the credit card has been cut off." The proposal is scheduled to be heard May 2.

The six former pension board members charged with conflict of interest are Ron Saathoff, a fire captain and the firefighters union president; Cathy Lexin, the city's former human resources director; Terri Webster, the former acting city auditor; Sharon Wilkinson, a management analyst; Mary Vattimo, the former city treasurer; and John Torres, a Police Department employee.

Saathoff, Lexin and Webster also face federal criminal charges, along with two former pension system officials.

In other action, the council delayed a decision that would pay the legal expenses of eight former City Council members, including former mayors Dick Murphy and Susan Golding, who are seeking to insert themselves into a case that is expected to decide the legality of pension benefits approved in 1996 and 2002.

None of the former council members is named in the lawsuit, but they want the city to pay for their legal fees.

Credit: STAFF WRITER

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

---

**Abstract** (Document Summary)

---

The council indemnified current and future pension board members in November 2002 – the same month the board approved a plan to allow the city to delay paying millions of dollars in benefit contributions to the pension system.

[Tony Young] also voted against the proposal last month when the council failed on a 4-1 vote to rescind the indemnification, with three council members -- Toni Atkins, Jim Madaffer and Scott Peters -- absent. All three voted against it yesterday, saying they worried about further legal entanglements if pension board members sue to recover legal costs.

The six former pension board members charged with conflict of interest are Ron Saathoff, a fire captain and the firefighters union president; Cathy Lexin, the city's former human resources director; Terri Webster, the former acting city auditor; Sharon Wilkinson, a management analyst; Mary Vattimo, the former city treasurer; and John Torres, a Police Department employee.

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.



## Aguirre nemesis to advise on pension | City attorney contends Pfingst 'hardly suited'

[1,2,6,7 Edition]

The San Diego Union - Tribune - San Diego, Calif.

Author: Philip J. LaVelle

Date: Mar 2, 2005

Start Page: A.1

Section: NEWS

Text Word Count: 1026

---

### Document Text

---

San Diego city officials have hired a nemesis of City Attorney Michael Aguirre to weigh in on a controversial pension-crisis matter that Aguirre views as his own.

If the intent was to get under Aguirre's skin, it appears to have worked.

Officials retained former District Attorney Paul Pfingst, a prominent Aguirre critic and onetime political foe, to advise them in a lawsuit filed by the city's retirement board.

Aguirre counterpunched via news release yesterday, ending it with this slap to the head:

"Paul Pfingst, who was removed from office for unethical behavior by San Diego voters and was caught using drugs while a New York prosecutor, is hardly suited to provide independent and reliable advice to the Mayor and City Council."

Fightin' words, to be sure, but Pfingst declined to take the bait.

He declined several attempts by a reporter to have that paragraph read to him so he could respond to it directly.

"I don't want to hear it," Pfingst said in a brief interview after appearing on a talk-radio show. "I don't care . . . I've been used to Mike's personal attacks over the years."

The Aguirre-Pfingst dust-up is the latest in a series of high-profile disputes between Aguirre and other officials over the pension troubles.

In his news release, Aguirre accused Mayor Dick Murphy and the City Council of violating the city charter and interfering with his duties, and he took some liberties with recent political history.

Pfingst wasn't exactly "removed from office for unethical behavior," which implies a recall election. In 2002, he lost his bid for a third term to challenger Bonnie Dumanis in a campaign in which the ethics of a top Pfingst deputy was among several issues.

Aguirre also ran in that contest, but was eliminated in the primary.

As for the drug reference, Aguirre was referring to an incident in the 1970s. Pfingst was asked to resign from his first job out of law school -- as a prosecutor in the Nassau County (N.Y.) District Attorney's Office -- for smoking marijuana and distributing a small amount of it at a party with several colleagues.

He was not prosecuted, went on to land another New York prosecutor's job and later became one of San Diego County's top trial attorneys -- as well as a controversial district attorney known for an aggressive and abrasive style.

Today, Pfingst is with the San Diego office of Higgs, Fletcher & Mack. He also does political and legal analysis for KUSI/Channel 51 and national cable news stations. He has been critical of Aguirre on the air.

Pfingst declined to discuss the substance of his work for the city or how much he is being paid -- only his client, he said, can ethically do that -- but he did confirm that he was planning to brief Murphy and the City Council at closed session last night.

At issue is a Superior Court lawsuit filed in late January by the city retirement board that names Aguirre and the city as defendants.

The lawsuit seeks to block Aguirre's bid to assume control of the legal affairs of the troubled \$3.6 billion pension system, ground zero in the city's ongoing financial problems that have been under investigation for more than a year by the Securities and Exchange Commission, the FBI and the U.S. Attorney's Office. Central to the investigations has been the city's underfunding of the pension system, which has a \$1.37 billion deficit.

In his news release, issued hours before the closed session began, Aguirre said Murphy and the council planned to hire outside lawyers to defend the retirement board suit instead of using Aguirre. He also said Pfingst would tell the mayor and council that Aguirre is not empowered to take over the retirement board's legal affairs, even though the Municipal Code indicates he can.

Aguirre called that purported opinion "ridiculous" and said he knew what Pfingst would say based on hallway conversations involving Pfingst that were picked up Monday at City Hall by an Aguirre staffer.

Murphy, attending a council meeting for much of the day, declined an interview request.

"The mayor will not discuss Mr. Aguirre's press release," said Murphy spokeswoman Colleen Windsor, "because it's a violation of the city's Ethics Code to publicly discuss the content of closed-session items."

Aguirre's language drew criticism from some quarters, while others questioned the selection of Pfingst.

"From what you read me, it sounds like Mike's losing it," political strategist Tom Shepard after hearing portions of Aguirre's news release.

"Even people who didn't vote for him (Pfingst) I think recognize that he's a very competent attorney," said Shepard, who ran Aguirre opponent Leslie Devaney's campaign last year.

"The reality is, there are not that many attorneys in San Diego that have experience in public law who would be in a position to competently offer advice on this. I suppose he is a provocative choice, but he's a good choice," Shepard said.

La Jolla lawyer Pat Shea, an informal Aguirre adviser, saw it differently.

"You've got to ask yourself, what's their motivation in hiring Paul Pfingst?" said Shea, whose wife, Diann Shipione, is on the retirement board and blew the whistle on irregular pension practices. Shea has also advocated, in several public forums, that the city declare bankruptcy as a means to untangle its finances.

Shea said: "There are professors from Stanford, professors from Harvard, professors from USC or USD, who are impartial and neutral and can do the analysis. So why do you pick someone that is a public personality who is openly critical of the city attorney, (critical) even before this issue arises?"

City Manager Lamont Ewell also was attending the council meeting yesterday and unavailable for comment. A top Ewell deputy did not return a phone call seeking comment.

Former longtime City Attorney John Witt said the language in Aguirre's news release was "unfortunate."

"I have the highest regard for Mr. Pfingst and I have high regard for Mr. Aguirre," Witt said. As for their political enmity, he added: "I would hope that people could overcome stuff like that."

Credit: STAFF WRITER

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

---

#### **Abstract** (Document Summary)

---

The [Michael Aguirre]-[Paul Pfingst] dust-up is the latest in a series of high-profile disputes between Aguirre and other officials over the pension troubles.

In his news release, issued hours before the closed session began, Aguirre said [Dick Murphy] and the council planned to hire outside lawyers to defend the retirement board suit instead of using Aguirre. He also said Pfingst would tell the mayor and council that Aguirre is not empowered to take over the retirement board's legal affairs, even though the Municipal Code indicates he can.

Aguirre called that purported opinion "ridiculous" and said he knew what Pfingst would say based on hallway conversations involving Pfingst that were picked up Monday at City Hall by an Aguirre staffer.

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

## Two city officials wage war of words | Use of outside legal staff latest bone of contention

[1,2,7 Edition]

The San Diego Union - Tribune - San Diego, Calif.

Author: Matthew T. Hall

Date: Mar 26, 2005

Start Page: B.1

Section: LOCAL

Text Word Count: 1048

---

### Document Text

---

City Manager Lamont Ewell and City Attorney Michael Aguirre are at odds over Ewell's decision to spend \$100,000 on outside legal staff to help San Diego respond to recent federal subpoenas for wide-ranging documents.

The dispute between two of San Diego's top officials escalated in recent days as they accused one another in dueling memos of undermining city efforts to comply with five U.S. grand jury subpoenas received since last month.

In a March 17 memo to Ewell, Aguirre accused him of causing "irrevocable harm" to the reliability and integrity of a set of notebooks from 2002 labor negotiations that weren't immediately turned over to the federal government.

Ewell replied in writing that Aguirre didn't have his facts right and that his "desire to see the city fail in its efforts is becoming increasingly more apparent, unprofessional and extremely harmful to the city's interests."

"Because my office can no longer rely on legal advice or services from the City Attorney's Office, with increasing frequency I am forced to turn to outside services," Ewell wrote in a Wednesday memo to Aguirre.

The pair's feud erupted as city officials worked around the clock in what Ewell called the largest document production in city history. The distrust between them, evident at City Council meetings since Aguirre took office in December, deepened recently when the City Manager's Office hired Aguirre rival Paul Pfingst to advise the council in a case naming Aguirre and the city as defendants. Pfingst, the former district attorney, was paid about \$10,000.

With the help of paralegals conducting what Ewell called "clerical work," city officials this week gave the U.S. Attorney's Office 90 boxes containing 117,000 documents related to the retirement system, labor negotiations, city representations to Wall Street credit-rating agencies and e-mail messages concerning a top aide to Mayor Dick Murphy. Over the past two weeks, hundreds of employees combed through e-mail messages, hard drives and files for the documents.

In an interview yesterday, Ewell said Aguirre's memo hinders San Diego's compliance with multiple ongoing federal investigations into city finances. Later, Aguirre said that compliance shouldn't be taking as long as it has.

"We're a year into the subpoenas," Aguirre said. "Everything should have been turned over before I even took office. People have to evaluate what's happening in light of that."

Two weeks ago, outside consultants hired to expedite the city's long-overdue fiscal 2003 audit asked Aguirre, Ewell and the nine-member City Council to sign a pledge to refrain from "personal criticism and accusation."

Aguirre and Councilwoman Donna Frye declined, citing their First Amendment right to free speech.

A week later, Aguirre sent a memo to Ewell accusing him of violating the city charter by locating and turning over city documents to the federal government without involving Aguirre's office in the process.

This week, Ewell responded by saying that "the most sensitive information" was collected by top city police officers who work closely with the FBI, and that the documents were turned over "while ensuring a proper chain of custody."

With his memo, Ewell included two e-mail messages Deputy City Attorney Anita Noone sent to the City Council on March 16. The first characterized Ewell and Aguirre as "working diligently and cooperatively" to respond to the subpoenas. But a corrected version that afternoon asked council members to disregard the first, saying Noone had not discussed it with Aguirre.

"In particular, I ask that you disregard my earlier description of the working relationship between the City Attorney and City Manager, and their staffs, as diligent and cooperative," Noone wrote.

The e-mail message also questioned Ewell's use of paralegals to respond to the subpoenas and his reliance on Paul Cooper, a former deputy city attorney who now works for the police chief, for legal advice.

Ewell said he hired the paralegals after Aguirre did not respond to a Feb. 25 memo seeking guidance on how to handle subpoenas.

Aguirre said he did not respond to that memo because he makes the procedure known every day.

"I have several people working full time on nothing but document production," he said. "The protocol is produce all the documents requested by the subpoenas. That's all the protocol you need."

Aguirre declined to comment on the competing claims that he and Ewell are undermining the federal investigations, saying the issue is under review by an audit committee made up of the consultants who proposed the letter of cooperation.

"I'm going to respect that process, and I'll wait to see if there's appropriate action taken by the audit committee before I say anything publicly," he said.

The \$3.6 billion San Diego City Employees Retirement System now has a \$1.37 billion deficit after the downturn in the stock market, increased employee benefits and intentional underfunding by the City Council since 1996.

The Securities and Exchange Commission is investigating allegations of securities fraud, and the U.S. Attorney's Office and the FBI are looking into possible public corruption. The inquiries began in February 2004.

This week, the District Attorney's Office announced its own investigation into the city's pension system and the board overseeing it.

Meanwhile, documents released this week under the California Public Records Act show that Pfingst, through his law firm, Higgs, Fletcher & Mack, billed the city \$10,322.90.

He advised the city over whether Aguirre had a conflict of interest in a lawsuit filed against him and the city in January by trustees of the retirement system. The bill was delivered Tuesday.

The lawsuit sought to block an Aguirre takeover of the system's legal affairs. It is now on hold pending efforts to resolve the city's financial crisis outside the courtroom.

Pfingst did not return a phone call seeking comment.

This week, Aguirre blasted the expected payment to Pfingst as "outrageous" and "grotesque."

"This is a complete waste of taxpayer funds," he said.

Ewell defended hiring Pfingst and the level of billing.

"I think the pricing was appropriate," he said.

Ewell said the city's relationship with Pfingst on this matter has ended.

He declined to say what advice Pfingst gave the mayor and council, saying it is confidential, closed-session information.

Matthew Hall: (619) 542-4599; matthew.hall@uniontrib.com

Credit: STAFF WRITER

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

---

**Abstract** (Document Summary)

---

The pair's feud erupted as city officials worked around the clock in what [Lamont Ewell] called the largest document production in city history. The distrust between them, evident at City Council meetings since [Michael Aguirre] took office in December, deepened recently when the City Manager's Office hired Aguirre rival Paul Pfingst to advise the council in a case naming Aguirre and the city as defendants. Pfingst, the former district attorney, was paid about \$10,000.

In an interview yesterday, Ewell said Aguirre's memo hinders San Diego's compliance with multiple ongoing federal investigations into city finances. Later, Aguirre said that compliance shouldn't be taking as long as it has.

With his memo, Ewell included two e-mail messages Deputy City Attorney Anita Noone sent to the City Council on March 16. The first characterized Ewell and Aguirre as "working diligently and cooperatively" to respond to the subpoenas. But a corrected version that afternoon asked council members to disregard the first, saying Noone had not discussed it with Aguirre.

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

**REPORT OF SAN DIEGO  
CITY ATTORNEY MICHAEL J. AGUIRRE  
REGARDING WHETHER THE SAN DIEGO  
CITY ATTORNEY IS COUNSEL TO THE SAN DIEGO  
CITY EMPLOYEES' RETIREMENT SYSTEM**

**OFFICE OF  
THE CITY ATTORNEY  
CITY OF SAN DIEGO**

**1200 THIRD AVENUE, SUITE 1620  
SAN DIEGO, CALIFORNIA 92101-4178  
TELEPHONE: (619) 236-6220**

**22 FEBRUARY 2006**

## **I.**

### **BACKGROUND**

On 15 December 2004 the San Diego City Attorney assumed the role of chief legal advisor to the Board of Administration of the San Diego City Employees' Retirement System ("SDCERS"). The City Attorney acted by virtue of his authority under Charter §40 of the San Diego City Charter. Charter §40 provides in pertinent part that the "City Attorney shall be the chief legal adviser of, and attorney for the City and all Departments and offices thereof in matters relating to their official powers and duties...."<sup>1</sup>

Municipal Code §22.1801 was adopted under Ordinance No. 8969 identifying City Retirement as a department of the City.<sup>2</sup> Thus, the San Diego City Attorney acts as legal counsel for City Retirement.<sup>3</sup> The San Diego Municipal Code provides that, unless otherwise provided by a memorandum of understanding between the City Attorney and the Board of Administration, "the City Attorney will designate one or more Assistant or Deputy City Attorneys to advise and represent the [SDCERS] Board in the administration of the System."<sup>4</sup>

---

<sup>1</sup> San Diego City Charter §40, attached as Exhibit 1.

<sup>2</sup> Ordinance No. 8969 adopted 25 February 1964, attached as Exhibit 3.

<sup>3</sup> San Diego City Municipal Code §22.1801 (b), attached as Exhibit 2.

<sup>4</sup> San Diego City Municipal Code §24.0910 states: "Legal Advisor to Board of Administration. Unless otherwise provided by Memorandum of Understanding between the City Attorney and the Board of Administration, the City Attorney will designate one or more Assistant or Deputy City Attorneys to advise and represent the Board in the administration of the System." ("Legal Advisor to Board of Administration" repealed; "Legal Advisor to Board of Administration" added 4-2-2002 by O-19043 N.S.), attached as Exhibit 4.



On 22 July 1998 the San Diego City Attorney and the SDCERS Board entered into a written Memorandum of Understanding “Regarding The Provision of Legal Services to the Board” (“22 July 1998 MOU”).<sup>5</sup> The San Diego City Attorney on 15 December 2004 revoked the 22 July 1998 MOU in a letter from the San Diego City Attorney to the SDCERS Board administrator.<sup>6</sup>

Notwithstanding the clear and unambiguous actions of the San Diego City Attorney to assert his authority under San Diego City Charter §40 to act as legal counsel for SDCERS, the Board of SDCERS refused to conform its actions to the requirements of Charter §40. The Board refused to allow the duly elected San Diego City Attorney to act as legal counsel to SDCERS. Instead, on 27 January 2005 the SDCERS Board brought a legal action in San Diego County Superior Court against the San Diego City Attorney asserting that the City Attorney was not authorized to act as legal counsel to SDCERS. By virtue of the fact that the SDCERS legal action has been pending since 27 January 2005, the San Diego City Attorney has been unable to exercise the power and authority granted him under Charter §40 to represent SDCERS. The SDCERS Board maintains<sup>7</sup> it is empowered to appoint the attorney for SDCERS, despite the Charter provision assigning to the people of the City of San Diego the authority to name the attorney for all City departments.<sup>8</sup>

---

<sup>5</sup> 22 July 1998 Memorandum of Understanding between the San Diego City Attorney and the SDCERS Board, attached as Exhibit 5.

<sup>6</sup> 15 December 2004 letter from the San Diego City Attorney to the SDCERS Administrator, attached as Exhibit 6.

<sup>7</sup> See, SDCERS civil action complaint against the San Diego City Attorney p. 12, attached as Exhibit 7.

<sup>8</sup> See San Diego City Charter §40, attached as Exhibit 1.

The San Diego City Attorney is elected by the people of the City of San Diego.<sup>9</sup> The composition of the SDCERS Board also is determined by an election of the voters of the City of San Diego.<sup>10</sup> The voters of the City of San Diego expressly decided on 7 April 1931 that the City Attorney was to be elected by the people of San Diego, as opposed to being appointed.<sup>11</sup>

On 6 December 2004 the current San Diego City Attorney took office.<sup>12</sup> The current San Diego City Attorney attempted to exercise his authority under Charter §40 upon his election. The SDCERS Board has failed and refused to obey the clear terms of San Diego City Charter §40, which places the authority to act as legal counsel to the pension board in the hands of the elected San Diego City Attorney.<sup>13</sup>

## **II.**

### **THE CITY ATTORNEY REPRESENTED SDCERS FROM ITS INCEPTION IN 1926**

On 29 November 1926 the Common Council of the City of San Diego unanimously adopted Ordinance No. O-10792 establishing “a retirement system for employees of The City of

---

<sup>9</sup> San Diego City Charter §40, attached as Exhibit 1.

<sup>10</sup> California State Constitution Article 16, §17(f) provides in relevant part that the number, terms, and method of selection or removal of members of public retirement board shall not be changed, amended, or modified unless ratified by a majority vote of the electors of the jurisdiction in which the participants of the system are or were, prior to retirement, employed, attached as Exhibit 8.

<sup>11</sup> See 7 April 1931 election returns for Proposition I, attached as Exhibit 9. The vote was 22,727 (79.76) in favor to 5,767 (20.24%) against.

<sup>12</sup> 6 December 2004 Certificate of Election of Michael J. Aguirre as San Diego City Attorney, attached as Exhibit 10.

<sup>13</sup> Complaint filed in SDCERS action against the San Diego City Attorney (Case No. 841845), attached as Exhibit 7.

San Diego.”<sup>14</sup> The San Diego City Attorney was made the attorney for the pension plan by the Common Council under Ordinance No. O-10792:

Legal Adviser

(6) The City Attorney of the City of San Diego shall be the legal adviser of the Board of Administration.<sup>15</sup>

### III.

#### **UNDER THE 1931 SAN DIEGO CITY CHARTER THE CITY ATTORNEY CONTINUED AS ATTORNEY FOR THE PENSION BOARD**

Drafters of the 1931 Charter of the City of San Diego explicitly continued the provisions of the previous pension system under Charter §148, which provided in pertinent part that it was the intent of the drafters to continue the pension system “in force and effect as existing at the time this Charter is adopted.”<sup>16</sup>

Moreover, the new Charter made the San Diego City Attorney the attorney for all departments and offices of the City.<sup>17</sup> The 1931 Charter expressly provided that: “The City Attorney shall be the chief legal adviser of, and attorney for the City and all Departments and offices thereof in matters relating to their official powers and duties....”<sup>18</sup>

The City Attorney is not empowered to delegate his duty to represent the SDCERS Board. In adopting Charter §40 the voters made it clear that they wanted the City Attorney to act

---

<sup>14</sup> See Ordinance No. 10792, 29 November 1926, attached as Exhibit 11.

<sup>15</sup> See Ordinance No. 10792, 29 November 1926 p. 9, attached as Exhibit 11.

<sup>16</sup> San Diego City Charter §148, attached as Exhibit 12.

<sup>17</sup> San Diego City Charter §40, attached as Exhibit 1.

<sup>18</sup> Charter §40, attached as Exhibit 1.

as the attorney for all departments and offices of the City. Under California law when such a delegation is made clear, it may not be avoided:

When the Legislature has made clear its intent that one public body or official is to exercise a specified discretionary power, the power is in the nature of a public trust and may not be exercised by others in the absence of statutory authorization.<sup>19</sup>

Powers conferred upon a municipal corporation and its officers and agents cannot be surrendered or delegated. Thus, the power of the municipal corporation or of its officers or agents to create positions cannot be delegated.<sup>20</sup>

In preparation for the 22 July 1998 MOU, the former City Attorney's Office analyzed the duties of the City Attorney to SDCERS as mandated by the City Charter. The City Attorney's Office considered:

If we are not their [attorney] per Ch §40, then

- 1) we can't [contract] away (or MOU away) anything, but
- 2) they have no basis for requiring us to provide any legal services...

\*\*\*

Fact that [Municipal Code] contemplates hiring outside counsel for [investment] purposes, then acknowledges that the City [Attorney] designates his person to be the Board's advisor, suggests that the [interpretation] of independent counsel is for investment advice.

BUT

If we are the Board's [attorney] per Ch §40, then we have a duty and a mandate under the Muni Code. That Muni Code allows outside investment counsel, but no other. It does not say "outside counsel for any purpose."<sup>21</sup>

---

<sup>19</sup> *Bagley v. Manhattan Beach*, 18 Cal. 3d 22, 24 (1976). Attached as Exhibit 13.

<sup>20</sup> *McQuillin Mun. Corp.* § 12.72 (3d ed.), attached as Exhibit 14.

<sup>21</sup> See Deputy City Attorney notes dated 20 March 1998, attached as Exhibit 43.

The City Attorney's Office thus concluded, months before entering the MOU, that it had a nondelegable duty under Charter section 40 to advise the retirement board. Counsel that may be retained by the Board, if any, pertains exclusively to counsel on investments. Notwithstanding, the then City Attorney entered into an MOU in July 1998 for others to perform his nondelegable duty to advise the retirement board.

#### **IV.**

#### **THE CITY ATTORNEY IS ELECTED TO MAXIMIZE THE CITY ATTORNEY'S INDEPENDENCE FROM ANY APPOINTING AUTHORITY**

The City Attorney was made an elected office by the 1930-1931 Charter Commission in order to keep the City Attorney independent. The Charter Commission was convinced by proponents of an elected City Attorney that putting the citizenry in charge of selecting the City Attorney would maximize the City Attorney's independence. This decision was made after considerable consultation with lawyers of the City of San Diego.

News stories and minutes of the 12 November 1930 Charter Commission meeting demonstrate that proponents of an elected City Attorney sought to maximize the City Attorney's independence. The local bar supported the theory that an elected City Attorney would be more independent than an appointed City Attorney, according to Charter Commission records. One news article of 12 November 1930, quoted in part below, explained that proponents of an elected City Attorney thought election would ensure that the City Attorney would be more independent:

#### **LAWYERS ARE ASKED TO AID FREEHOLDERS**

7 TO 7 Deadlock On City Attorney Will Be Put To Attorneys

Local attorneys are invited to attend the meeting of the board of freeholders in the director's room of the San Diego Museum Balboa park, tonight at 7 o'clock to help the charter framers solve this question:

Under the new charter, should the city attorney be elected by the people or should he be chosen by the council?

With John Snyder out of the city, the board found itself first standing 7 to 7 on this question, when it met at 7 o'clock and after seven motions of one sort or another, still stood 7 to 7. As the net result of this supposedly lucky number, the press was asked to extend an invitation to local attorneys to attend tonight's meeting and express their views.

Those of the freeholders who favor election by the people feel that the city attorney should be a check on the council and the city manager, and that only his election by the people will give him the necessary independence of action.\*\*<sup>22</sup>

The minutes of the 12 November 1930 Charter Commission meeting show that several attorneys showed up and offered their view that the City Attorney should be elected and not appointed in order to make the City Attorney independent from any appointing authority. After hearing from the attorneys, the Charter Commission voted 8 to 5 in favor of an elected City Attorney.<sup>23</sup>

While the Charter was under submission to the voters during the 1931 election campaign, Charter Commission member Ray Mathewson provided a written explanation of the goal behind making the City Attorney an elected rather than appointed position:

The city attorney is elected by the people. At the present time he is appointed by the council. It was felt that if the attorney were elected by the people, he would be in a much more independent position than if he were appointed by the council. The council may employ special water counsel to aid the city attorney.<sup>24</sup>

Mr. Mathewson had previously explained that the City Attorney, as an elected rather than an appointed official, would have "complete independence":

The duty of the city attorney is to give legal advice to every department and official of the city government on municipal matters. He also must act as the

---

<sup>22</sup> 12 November 1930 News Article Lawyers Are Asked to Aid Freeholders, attached as Exhibit 15.

<sup>23</sup> 12 November 1930 Charter Commission Minutes, p. 2, attached as Exhibit 16.

<sup>24</sup> 1 April 1931 article "Council Must Elect Manager in Two Months" (Ray Mathewson), attached as Exhibit 17.

representative of the various departments before the courts. He should occupy an independent position so that his opinions would not be influenced by any appointive power. For this reason he should be elected by the people. If elected, the city attorney is in a position of complete independence and may exercise such check upon the actions of the legislative and executive branches of the local government as the law and his conscience dictates.<sup>25</sup>

Again, the rationale for having the City Attorney elected by City voters was to ensure the City Attorney's independence. The objective of creating an independent City Attorney was set forth in a letter to the elected City of San Diego Charter Commission that decided to put the proposal to elect the City Attorney on the 7 April 1931 ballot.<sup>26</sup> The letter was authored by James G. Pfanstiel to 1930-1931 Charter Commission Chairman Nicholas J. Martin.<sup>27</sup> Pfanstiel previously served on the 1929 City of San Diego Charter Commission, which proposed a Charter that was voted down in 1930.<sup>28</sup> The letter from Pfanstiel to Martin explained the rationale behind electing the City Attorney:

ARTICLE FIVE, SECTION FIFTEEN. – Some advocated with considerable degree of force that the city attorney should be elected by the people. The argument is that the city attorney is the attorney for the entire city and each and every elective and appointive officer thereof upon all questions pertaining to the municipality, and he should occupy an independent position so that his opinions may be uninfluenced by any appointive power. It would seem that if the city

---

<sup>25</sup> Rough Draft of a Proposed "Strong Mayor" Council Form of Government p. 2, attached as Exhibit 18.

<sup>26</sup> See 12 September 1930 letter from James G. Pfanstiel to 1930-1931 Charter Commission member Nicholas J. Martin, attached as Exhibit 19.

<sup>27</sup> See news article "City Attorney To Be Elective Board Decides," attached as Exhibit 20.

<sup>28</sup> See 12 September 1930 letter from James G. Pfanstiel to 1930-1931 Charter Commission member Nicholas J. Martin, attached as Exhibit 19; News article "New Charter For S.D. Gets Endorsement, Member of 1929 Board of Freeholders Approves City Proposal," attached as Exhibit 21.

attorney is elected by the people he should have the power to appoint his deputies without civil service regulations, subject, of course, to budget control.<sup>29</sup>

A brochure used to inform voters about the position of an elected San Diego City

Attorney distributed in connection with the April 1931 election explained that electing the City

Attorney would guarantee protection of the public interest:

**INDEPENDENT CITY ATTORNEY**

The city attorney is to be elected by the people. This is a guarantee that the legal head of the government will be able to fearlessly protect interests of all San Diego and not merely be an attorney appointed to carry out wishes of council or manager.<sup>30</sup>

**V.**

**THE PENSION BOARD PRESIDENT HAS ADMITTED  
THE CITY ATTORNEY IS THE PENSION BOARD LAWYER**

The SDCERS Board President admitted that the San Diego City Attorney is the attorney for the SDCERS Board on at least two occasions. On 9 April 1997 SDCERS Board President Keith Enerson admitted the San Diego City Attorney is the attorney for the SDCERS Board under the San Diego City Charter. In the recitals section of a 9 April 1997 agreement between the San Diego City Attorney and the SDCERS Board, paragraph "A" explicitly stated the City Attorney is the attorney for the SDCERS Board: "A. Pursuant to section 40 of the Charter for the City of San Diego ("Charter section 40"), the City Attorney is the attorney for the City and the Board."<sup>31</sup>

---

<sup>29</sup> See 12 September 1930 letter from James G. Pfanstiel to 1930-1931 Charter Commission member Nicholas J. Martin, attached as Exhibit 19; A.R. Sauer news article describing the defeat of the 1929 Charter proposal, attached as Exhibit 22.

<sup>30</sup> Election brochure from 7 April 1931 election entitled "Facts About the Proposed City Charter," attached as Exhibit 23.

<sup>31</sup> 9 April 1997 Agreement for Retirement System Legal Services, attached as Exhibit 24.



On 25 August 1995 the President of the SDCERS Board again admitted that the City Attorney provided legal services to the SDCERS Board under the mandate of the San Diego City Charter. An agreement between the SDCERS Board and the San Diego City Attorney dated 25 August 1995, signed by SDCERS Board President Keith Enerson, provided in pertinent part:

1. The City Attorney provides legal services to the Board pursuant to the mandate of Section 40 of the San Diego City Charter.<sup>32</sup>

California law<sup>33</sup> allows statements to be admitted as evidence if the “statement was made by a person authorized by the party to make a statement or statements for him concerning the subject matter of the statement.”<sup>34</sup> The San Diego Municipal Code requires and authorizes the SDCERS Board President to make statements on behalf of SDCERS.

Specifically, unless otherwise governed by state or federal law, the SDCERS Board President is empowered and required to “promptly inform the City Manager and the City Council of all material facts or significant developments relating to all matters under the jurisdiction of the [SDCERS] Board.”<sup>35</sup> Moreover, Rule 2.01 of the Rules of the Retirement Board of Administration gives the SDCERS Board President broad powers.<sup>36</sup> Thus, statements by SDCERS Board President Keith Enerson that the City Attorney is the attorney for the SDCERS

---

<sup>32</sup> 25 August 1995 Memorandum of Understanding between the Office of the San Diego City Attorney and the SDCERS Board, attached as Exhibit 25.

<sup>33</sup> California Evidence Code §1222.

<sup>34</sup> California Evidence Code §1222, attached as Exhibit 26.

<sup>35</sup> Municipal Code §24.0911 (c), attached as Exhibit 27.

<sup>36</sup> Rules of the Retirement Board of Administration §2.01, attached as Exhibit 28.

Board are authorized and binding admissions by SDCERS that the City Attorney is in fact the attorney for the SDCERS Board.<sup>37</sup>

## **VI.**

### **THE SAN DIEGO CITY ATTORNEY HAS TERMINATED THE MEMORANDUM OF UNDERSTANDING WITH SDCERS**

A 22 July 1998 Memorandum of Understanding (22 July 1998 MOU) allowed the SDCERS Board to retain its own Legal Services Department to “fulfill its fiduciary and administrative responsibilities to the System.”<sup>38</sup> On 2 November 2004 the people of San Diego elected a new City Attorney, who was sworn in on 6 December 2004.<sup>39</sup> On 15 December 2004 the new San Diego City Attorney terminated the 22 July 1998 MOU by letter.<sup>40</sup>

The 15 December 2004 letter from the City Attorney to the SDCERS Board Administrator provided:

Effective immediately the undersigned assumes the role of chief legal advisor to the Board of Administration of the Retirement System.

\*\*\*

Prior to 1998, the office of the City Attorney provided legal services to the Board by assigning deputy City Attorneys to give day-to-day legal advice on a variety of issues. By 1998, sdCERS sought to replace the City Attorney with a “General Counsel” to the Board of Administration, separate from the control and oversight of the City Attorney. Notwithstanding the clear conflict with the Charter, and the possibility for behavior inconsistent with the interests of the people of the City of San Diego, it argued its right to do so under California Constitution Article XVI,

---

<sup>37</sup> California Evidence Code §1222, attached as Exhibit 26.

<sup>38</sup> 22 July 1998 Memorandum of Understanding between the San Diego City Attorney and the SDCERS board, attached as Exhibit 5.

<sup>39</sup> 6 December 2004 Certificate of Election of Michael J. Aguirre, attached as Exhibit 10.

<sup>40</sup> 15 December 2004 letter from San Diego City Attorney to SDCERS Board Administration, attached as Exhibit 6.

section 17 (Proposition 162), which was read by sdCERS to grant to it plenary (argued to mean exclusive and unfettered) authority over the System.

The City Attorney did not concur with the Board's analysis of the applicable law, but capitulated to the Board's demand. On November 18, 1998, an ordinance was passed which: 1) specifically reflected the position of the Board demanding the right to appoint its own separate General Counsel and achieve the repeal of Municipal Code Sec. 24.0910; 2) specifically reflected the objection of the City Attorney to the Board's desire to repeal the Municipal Code provisions for City Attorney's participation as mandated by the Charter; and 3) resolved the matter by providing for the option of a General Counsel position to the sdCERS Board under a Memorandum of Understanding between the City Attorney and the Board. Municipal Code Sec. 24.0910 was adopted specifically retaining the City Attorney's Charter rights as legal counsel to the Board but also providing for the alternate General Counsel's) under a Memorandum of Understanding.

There was no term to the Memorandum of Understanding agreement.

The undersigned City Attorney discontinues any effect of the above-mentioned MOU and assumes the role of chief legal advisor to the Board of Administration of the Retirement System effective immediately ....<sup>41</sup>

The 15 December 2004 letter provided three grounds on which the City Attorney relied to assert his authority to act as legal counsel to the SDCERS Board. The City Attorney stated: (1) the former City Attorney had no authority to bind him, (2) the term of the 22 July 1998 MOU was confined to the term of the prior City Attorney's term in office and (3) Article 16, §17 of the California State Constitution did not extinguish the authority of the San Diego City Attorney to act as legal counsel to the SDCERS Board.<sup>42</sup>

The Memorandum of Understanding (MOU) at issue is an agreement governed by general contract principles. See *Chula Vista Police Officers' Assn. v. Cole*, 107 Cal. App. 3d 242, 246 (1980) [interpretation of MOU under the Meyers-Millias-Brown Act governed by the

---

<sup>41</sup> 15 December 2004 letter from San Diego City Attorney to SDCERS Board Administration, attached as Exhibit 6.

<sup>42</sup> *Id.*

same rules applicable to private contracts]. Absent state law to the contrary, all contracts, whether public or private, are to be interpreted by the same rules. Cal. Civ. Code §1635.

Generally, if a contract, such as an MOU, fails to include an express provision for its duration, and one cannot infer the intent of the parties as to duration from the nature of the contract and the circumstances surrounding it, the term is held to be at least a reasonable time, with obligations under the contract terminable at will by any party on reasonable notice after such reasonable time has elapsed. *Consolidated Theatres, Inc. v. Theatrical Stage Employees Union*, 69 Cal. 2d 713, 727-728 (1968). In *Consolidated Theatres, Inc., v. Theatrical Stage Employees Union*, 69 Cal. 2d 713, 727-728 (1968), a case involving theatrical labor unions, the contract at issue similarly lacked an express or implied term of duration. If neither an express nor an implied term can be found, the court will generally construe the contract as terminable at will. *Id.* at 727.

The MOU at issue does not include an express provision for its duration. The MOU was in effect approximately six-and-one-half years (from July 22, 1998 to December 15, 2004) before the new City Attorney sent a letter terminating the agreement. The MOU was in effect through the remainder of the term in office of the prior City Attorney who signed the agreement. This clearly was a “reasonable time” under which legal services were provided to the Board by outside counsel.

Moreover, Section D of the MOU at issue confirms that this agreement was not intended to remain in effect indefinitely. In Section D, the prior City Attorney expressly contested the Board’s legal arguments and, thus, the legal basis of the agreement. The agreement expressly stated that the City Attorney did not waive his position regarding his rights and responsibilities to

the Retirement System under the City Charter. This provision confirms the City Attorney could take action to terminate the MOU at a later date, upon reasonable notice.

## **VII.**

### **APPOINTED SDCERS ATTORNEYS HAVE NOT BEEN INDEPENDENT FROM THE SDCERS BOARD**

Since approximately 25 August 1995, the SDCERS attorney has not been independent from the SDCERS Board. On that date the San Diego City Attorney entered into a legal services agreement with the SDCERS Board. The agreement provided that Deputy City Attorney Loraine E. Chapin would be “housed exclusively and entirely at the Retirement Office.”<sup>43</sup> Chapin drafted the agreement.<sup>44</sup> Since that time, SDCERS has received legal advice from in-house legal staff who work closely with certain members of the SDCERS Board. The attorney for the SDCERS Board has now been indicted by a federal grand jury for conspiracy to commit wire and mail fraud, mail fraud and wire fraud.<sup>45</sup>

While the SDCERS Board operated without independent counsel, the retirement system made decisions supported by General Counsel Chapin that resulted in the pension system’s substantial financial decline.<sup>46</sup> There is a serious issue as to whether the SDCERS General

---

<sup>43</sup> 25 August 1995 legal services Memorandum of Understanding between the San Diego City Attorney and the SDCERS Board, attached as Exhibit 25.

<sup>44</sup> 25 August 1995 legal services Memorandum of Understanding between the San Diego City Attorney and the SDCERS Board (see LEC initials p. 3), attached as Exhibit 25.

<sup>45</sup> Indictment in *United States of America v. Ronald Saathoff* et. al., dated 6 January 2006 (Criminal Case No. 06CR0048 BEN), attached as Exhibit 29.

<sup>46</sup> See 2004 SDCERS Actuarial Report finding that the SDCERS funding deficit exceeds \$1.4 billion, attached as Exhibit 30; see San Diego City Attorney’s Interim Reports 1, 2, 3, 6 and 7.

Counsel violated the conflict of interest provisions of California law, which could render the 22 July 1998 MOU null and void.

Chapin wrote four legal opinions addressing whether the City Attorney was to be counsel for the SDCERS Board and detailing how she came to be SDCERS General Counsel.<sup>47</sup> As Deputy City Attorney, Chapin worked to create a General Counsel position at SDCERS and to secure her appointment to that position. The lack of independence of the SDCERS counsel led to a chain of events that spiraled SDCERS into its present crisis. These events illustrate the wisdom of the drafters of the City's 1931 Charter, who wanted the independent City Attorney to serve as the SDCERS attorney.

In a 22-page legal memorandum entitled "Legal Services for the Retirement Board," dated 25 April 1996, Chapin recounts a meeting she held with former City Attorney John Witt, City Attorney Casey Gwinn, and attorneys John Kaheny and Stu Swett. At the meeting, Chapin "recommended that the City Attorney permit the Retirement Board to secure the services of legal counsel of its choice to assist it with its charter-mandated investment and administrative duties."<sup>48</sup> Chapin wrote that Charter §40 permitted the SDCERS Board "to secure the legal counsel of its choice to assist it with its charter-mandated investment and administrative responsibilities." She also found that "Ethical, political, practical and financial considerations

---

<sup>47</sup> 25 April 1996 Memorandum from Lori Chapin to Les Girard, Chief Deputy, entitled "Legal Services for the Retirement Board, attached as Exhibit 31; 6 May 1998 Memorandum from Lori Chapin, SDCERS General Counsel to The Business and Procedures Committee, via Lawrence B. Grissom, Retirement Administrator, attached as Exhibits 32, 35, 36.

<sup>48</sup> *Id.* at 1.

favor a recommendation by the City Attorney to permit the Retirement Board to secure the legal counsel of its choice . . .”<sup>49</sup>

On 20 December 1996, the SDCERS Board approved the establishment of the position of General Counsel to provide legal services for the Board.<sup>50</sup> On 16 January 1997, the SDCERS Board President recommended that the SDCERS Board “direct Staff to move forward with the steps necessary to convert by July 1, 1997, current Deputy City Attorney Chapin, to Board personnel, in the position of General Counsel.”<sup>51</sup>

On 17 January 1997 SDCERS Board member Ron Saathoff recommended that Chapin be hired as SDCERS General Counsel:

## 2. Process Regarding Legal Services to the Retirement Board

Mr. Saathoff stated Staff’s recommendations regarding this issue has been distributed. He summarized by saying Staff is recommending that the Board retain Lori Chapin as in-house legal counsel to this Board.<sup>52</sup>

The SDCERS Board unanimously approved Chapin’s hiring as General Counsel of the SDCERS Board. On 22 January 1997, Chapin wrote a memo to Casey Gwinn confirming the SDCERS Board’s decision to hire her as SDCERS Board’s General Counsel and her decision to take the new position:

Last Friday, January 17, 1997, the Retirement Board unanimously approved a recommendation made by Keith Enerson, the Board’s President to direct Retirement Staff to move forward with the steps necessary to convert by July 1, 1997, my position as a deputy city attorney advising the Board to the position of

---

<sup>49</sup> *Id.* at 2; attached as Exhibit 31.

<sup>50</sup> 16 January 1997 Memorandum from SDCERS Board President Keith Enerson to the SDCERS Business and Procedures Committee, attached as Exhibit 33.

<sup>51</sup> *Id.*

<sup>52</sup> 17 January 1997 SDCERS Board Minutes (p. 7), attached as Exhibit 34.

General Counsel to the Board, a position yet to be created. This action was in response to your oral and written requests to the Board President in June and November, 1996, respectively to fashion a new relationship for the provision of legal services which would meet the Board's concerns and your responsibilities as the City Attorney providing legal advice to the City Council, Retirement Board and ultimately the taxpayer.<sup>53</sup>

In her 22 January 1997 memorandum, Chapin admitted she was "the deputy city attorney advising the Retirement Board for the past six years..."<sup>54</sup> Chapin admitted in her 22 January 1997 memorandum that she was instrumental in creating the General Counsel position, a position she would advance to under the new legal services plan:

As the result of my personal experience, I prepared confidential memoranda to you and Les Girard in April through June, 1996, regarding the City Attorney's legal responsibilities under Charter §40. I shared with you the need to educate the Council and bring to its attention the need to evaluate, review and consider changes to the plan document resulting from changes in federal, state and local law.<sup>55</sup>

Finally, Chapin provided background showing how she positioned herself to take the new General Counsel position with SDCERS:

In June 1996, you, John Witt, John Kaheny and I met with Keith Enerson and Larry Grissom regarding legal services for the Retirement Board. Keith informed the group of the Board's desire to retain legal counsel of its choice to assist it with its Charter-mandated investment and administrative responsibilities. You asked the Board to evaluate its needs and submit a request for legal services. As the future City Attorney for the City Council, Retirement Board and ultimately the taxpayer, you indicated your willingness to work with the Retirement Board to fashion a new relationship for the provision of legal services which met both the Board's concerns and your responsibilities to the Board, City Council and taxpayer.<sup>56</sup>

---

<sup>53</sup> 22 January 1997 memorandum from Lori Chapin to Casey Gwinn entitled "Legal Services to the Retirement Board," attached as Exhibit 35.

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*



Chapin then explained her transition from Deputy City Attorney to SDCERS General

Counsel:

- I would remain a deputy city attorney until July 1, 1997. I would remain located in the Retirement Office. I would continue to provide legal services to the Board. The same would be true with Roxanne Parks and Merlita Hilario. (They are tied into the reimbursement process as well. They are an integral part of by (my) ability to provide the level of service the Board has grown accustomed to expect and demand.)
- You would continue to be reimbursed for my services, as well as those of Roxanne Parks and Merlita Hilario until July, 1997.<sup>57</sup>

Chapin closed her 22 January 1997 memorandum by discussing the opportunities the new arrangement provided for her and others:

In closing, I did not fully realize the enormity of the pressure and strain I had been laboring under until the Board action on Friday. For the first time I was reminded of the possibilities and incredible opportunities for you, me, the Office, and the Council and the City available with a reconsideration of the way legal services are provided to the Board. A weekend in Big Bear with my family provided the perfect opportunity for these ideas to resurface and take form. The creative juices began to flow. So many ideas surfaced I had to grab a pen and pencil and write them down before they got lost in the crowd.<sup>58</sup>

On 11 March 1997 Chapin wrote the City Attorney to request that he sign off on the creation of her new position as SDCERS' General Counsel:

Under your direction, an Agreement For Retirement System Legal Services ("Agreement") has been drafted and signed by the President of the Retirement Board. It awaits your signature. This agreement authorizes the creation of a separate Legal Services Division for the Retirement Board consisting of three positions, General Counsel, Assistant General Counsel and Administrative Legal Secretary. It is contemplated the positions will be included in the FY 98 Annual Appropriations Ordinance, effective July 1, 1997. To accomplish this in the most efficient and timely manner, I need your help.

---

<sup>57</sup> *Id.* at 6.

<sup>58</sup> *Id.* at 8.

\*\*

Finally, I wanted to let you know I have scheduled a meeting with Stu Swett for Wednesday, March 12, to discuss the procedures for creating the new positions. I asked for this meeting because I was informed he is usually involved in these matters. Please let me know if this proposed course of action meets with your approval. Thank you for your assistance.<sup>59</sup>

Chapin's involvement in influencing the creation of the General Counsel's position at SDCERS and in influencing her appointment to the position as its general counsel raise the issue of whether she violated Government Code §1090. Under Government Code §1090 public officials are prohibited from "being financially interested in any contract made by them in their official capacity."<sup>60</sup> If Chapin made a contract in her official capacity in which she had a financial interest and thereby violated §1090, the underlying contract is void.<sup>61</sup>

In *People v. Sobel* the court outlined the broad reach of Government Code §1090:

The decisional law, therefore, has not interpreted section 1090 in a hypertechnical manner, but holds that an official (or a public employee) may be convicted of violation no matter whether he actually participated personally in the execution of the questioned contract, if it is established that he had the opportunity to, and did, influence execution directly or indirectly to promote his personal interests.<sup>62</sup>

Government Code §1090 is aimed at eliminating temptation, avoiding the appearance of impropriety, and assuring the government of the officer's undivided and uncompromised allegiance.<sup>63</sup> Its constraints appear to be designed to prohibit self-

---

<sup>59</sup> 11 March 1997 memorandum to Casey Gwinn relating to the Status of Legal Services for the Retirement Board, attached as Exhibit 36.

<sup>60</sup> Government Code §1090, attached as Exhibit 37.

<sup>61</sup> See, *People v. Sobel*, 40 Cal.App.3d 1046 (1974), attached as Exhibit 38.

<sup>62</sup> *Id.* at 1052.

<sup>63</sup> See *Finnegan v. Schrader*, 91 Cal. App. 4th 572, 580 (2001) [employment agreement set aside because employee involved in contract]; see, *Campagan v. City of Sanger*, 42

serving actions such as those of Chapin, who used her position as a Deputy City Attorney to gain the position of General Counsel for the SDCERS Board.<sup>64</sup>

The federal indictment charges that Chapin, as SDCERS General Counsel, was head of the SDCERS Legal Services Division and “had the duty to provide legal advice and assistance to the SDCERS Board.”<sup>65</sup> Further the federal indictment alleges Chapin had a duty to keep the SDCERS Board fully informed of material facts:

As the General Counsel of SDCERS, defendant Chapin had a duty to keep the SDCERS Board fully informed of all material information, including information about (a) proposals that could affect the funding of SDCERS, (b) SDCRS Board decisions that could impact the financial interest of an SDCERS Board Trustee, (c) whether SDCERS Board Trustees and staff were complying with state and federal laws, and (d) whether an SDCERS Board Trustee had a conflict of interest.<sup>66</sup>

The federal indictment describes a 2002 scheme in which the SDCERS Board allowed the City of San Diego to pay less into SDCERS than was necessary to ensure full funding of pension benefits.<sup>67</sup> The indictment also alleges Chapin concealed from members of the SDCERS Board the fact that a proposal coming before the SDCERS Board would allow Ron Saathoff, a board member, to receive a \$25,000 per year increase in his pension benefit.<sup>68</sup>

---

Cal. App. 4th 533 (1996) [Set aside attorney contingency employment agreement of City Attorney who was involved in contract’s formation].

<sup>64</sup> Chapin’s actions may also have violated the conflict of interest provisions of the Political Reform Act, Government Code §81000, *et seq.* The City Attorney’s office is reviewing whether to initiate a civil enforcement action.

<sup>65</sup> Indictment U.S. v. Saathoff (p. 4), attached as Exhibit 29.

<sup>66</sup> *Id.* at 5.

<sup>67</sup> *Id.*

<sup>68</sup> *Id.* at 6.

The federal indictment charges that Chapin stood to gain from another provision in the same proposal: “If enacted, these increased benefits would have raised the retirement benefits for defendants SAATHOFF, LEXIN, WEBSTER, GRISSOM, and CHAPIN.”<sup>69</sup> The indictment also alleges Chapin acted in order to maintain her position with SDCERS.<sup>70</sup>

The decision to allow the SDCERS Board to appoint its attorney has led to a series of abuses. The voters in 1931 sought to avoid by making the attorney for the pension and for all other city departments answerable to the voters and independent from any the appointing authority. Thus, there is not only a strict legal requirement that the City Attorney be allowed to assert his authority as legal counsel to the SDCERS Board, but practical considerations urge the same result.

## VII.

### **THE CALIFORNIA STATE CONSTITUTION DOES NOT LIMIT THE CITY ATTORNEY’S AUTHORITY TO ACT AS THE PENSION BOARD ATTORNEY**

SDCERS has argued that Article 16, §17 of the California Constitution divests the City Attorney of his Charter-mandated responsibility to serve as its chief legal counsel. Article 16, §17 was enacted to protect public pension funds from abuse, political meddling, and corruption.

Looking back over the past nine years, since SDCERS retained its own counsel, it is absolutely apparent that allowing SDCERS to avoid the counsel of the City Attorney has served the ends of abuse and corruption. Rather, the SDCERS administration – including its in-house counsel – engaged in a breach of its fiduciary duties. The result is a well-publicized unfunded pension liability approaching two billion dollars to SDCERS and a historically low funding level,

---

<sup>69</sup> *Id.*

<sup>70</sup> *Id.* at 12.

jeopardizing the security of pension beneficiaries for generations to come. SDCERS has used its asserted “independence” not to shield the fund from abuse and corruption, but to shield its own abuses and corruption from public scrutiny. This fact is underscored by the indictment of six former SDCERS Board members for felony self-dealing.

The people’s Charter-based right to appoint their independently elected City Attorney as chief legal counsel for the city employees’ retirement system complies with all relevant laws, including Article 16, §17 of the California Constitution. In fact, having the City Attorney act as general counsel for SDCERS furthers the expressed public interest in enacting that Constitutional section – the protection of public pension funds from abuse and corruption. It does not interfere with the SDCERS Board’s plenary authority over management of assets and distribution of benefits, because the City Attorney has no role in making management decisions. It does not subject the system to any danger that retirement funds will be misused by the City.

Contrary to the suggestion of SDCERS, the San Diego City Attorney is not simply another arm of City bureaucracy. The City Attorney is an independently elected official, vested with responsibility to provide counsel to all City departments. The City Attorney stands as another check against potential corruption and wrongdoing between City officials and others who might misuse their office to the detriment to the City, the retirement system, and/or plan participants.

The right of the people of San Diego to govern their own municipal affairs is protected by Article 11, §5 of the California Constitution, which includes regulation of the City Employees’

Retirement System. Regulation of a public pension system consistently has been held to be a municipal affair.<sup>71</sup>

“Proposition 162,” which California voters passed in 1992 and which is codified as California Constitution Article 16, §17, does not conflict with San Diego City Charter provisions vesting the City Attorney with the authority to represent the pension system. Although that section provides that the pension board shall have “plenary authority and fiduciary responsibility for investment of moneys and administration of the pension system,” it has been made clear by the courts and the language of that section that authority of the pension system is limited to administration and investment of its assets, provision of benefits, and provision of actuarial services.<sup>72</sup> As stated by the Third District Court of Appeal in *Westly v. California Public Employees’ Retirement System Board of Administration, et al.*, 105 Cal.App.4th 1095, 1113:

We have concluded that the powers the voters intended to give the Board (in enacting Proposition 162) do **not** include the exclusive and unfettered authority over payments made to and on behalf of its members and employees. Rather, the extent of the Board’s authority *is limited to the specific areas enumerated in the Section*. *Westly* at 1113, emphasis added.

The specific areas are, again, administration of investments, provision of benefits, and provision of actuarial services.

By contrast, Section 17 does not give power to a retirement board to select governing personnel. In fact, power is expressly reserved to the people to make key personnel decisions,

---

<sup>71</sup> *Grimm v. City of San Diego*, (1979) 94 Cal.App.3d 33, 37 [the right of the people is so closely guarded that only if another Constitutional provision directly and expressly conflicts will a City Charter be overruled]. As stated by our own California Supreme Court in *City of Grass Valley v. Wilkinshaw*, 34 Cal.2d 595 (1949), “(i)f there is any question of the application of the Constitution, the Constitution must be strictly interpreted in favor of municipal power and against the existence of any limitation not expressly stated. *City of Grass Valley v. Wilkinshaw*, 34 Cal.2d 595, 599 (1934). These cases are attached as Exhibits 39 and 40.

<sup>72</sup> *Westly v. California Public Employees’ Retirement System Board of Administration, et al.*, 105 Cal.App.4th 1095, 1113. Attached as Exhibit 41.

including determination of the board itself. Subsection (f) provides that the composition of a retirement board cannot be changed, amended or modified unless the change, amendment or modification *is ratified by a majority vote of the electors in the jurisdiction in which the participants of the retirement system are or were, prior to retirement, employed.*

The argument that California Constitution Article 16 §17 provides exclusive authority to a pension board to make key staffing decisions, such as employment of counsel, was considered and rejected in *Westly, supra*. *Westly* involved an attempt by the state pension board to avoid state-imposed limitations on the compensation of its members and employees. Similar to the argument made by SDCERS, the state retirement board argued that regulation of its expenditures would make it impossible for the Board to comply with its fiduciary duties under Section 17. The court rejected this argument, finding: 1) the right to determine the compensation of state employees was specifically granted by the Legislature to the State Controller; and 2) the “plenary authority” granted the board under Section 17 did not immunize the Board from regulation that did not conflict with its provisions.

Significantly, in reaching its decision, the *Westly* court noted that the State Controller, just like the San Diego City Attorney, was entrusted by the people with certain responsibilities that affected the administration of the system. The court rejected the Retirement Board’s attempt to determine its own rules: “An attempt by an administrative agency to exercise control over matters which the legislature has not seen fit to delegate to it *is not authorized by law and in such cases the agency’s actions can have no force or effect.*”<sup>73</sup>

Similarly, in *Singh v. Board of Retirement of the Imperial County Employees’ Retirement System*, after analyzing the voter intent behind Proposition 162, the Fourth District Court of

---

<sup>73</sup> *Westly* at 1106 (emphasis added). Attached as Exhibit 41.

Appeal rejected a retirement board's claim that the term "plenary authority" insulated the retirement board's administrative decisions from review by the Superior Courts.<sup>74</sup> In limiting the meaning of "plenary authority," the court recognized that the voter intent behind the Proposition was to "(a) remov[e] the Legislature's authority to make investment decisions, and (b) established that a system's primary obligation was to its members and beneficiaries."<sup>75</sup>

In sum, nothing in California Constitution Article 16, §17 has ever been interpreted by courts to insulate SDCERS from governance by the people. Rather, courts have consistently held that public retirement boards remain subject to control by the people and the courts.

### **VIII.**

### **CONCLUSION**

Voters of the City of San Diego made the office of City Attorney independent of any constituencies of the City to whom the City Attorney renders legal advice and counsel. A former Deputy City Attorney used her position to influence government decisions that created a general counsel position for herself as counsel for the SDCERS Board. Under this arrangement the City Attorney did not act as an independent attorney for the SDCERS Board.

Upon his elevation to the position of San Diego City Attorney, a new City Attorney terminated the agreement allowing the SDCERS Board to be advised by an attorney of its choice. Instead, the City Attorney invoked his authority to act as legal counsel to the SDCERS Board. The voters of the City of San Diego made a political decision in 1931 to ensure the City Attorney would advise all City departments, including the retirement system, so that counsel for those entities would remain independent from any appointing authority.

---

<sup>74</sup> *Singh v. Board of Retirement of the Imperial County Employees' Retirement System*, 41 Cal.App.4th 1180, 1185 (1996). Attached as Exhibit 42.

<sup>75</sup> *Id.* at 1191.



Based on this history, the City Attorney has the authority to reassert his right to act as the independent legal counsel for the SDCERS Board.

By \_\_\_\_\_  
Michael J. Aguirre  
City Attorney

# Exhibit 31



# San Diego City Attorney **MICHAEL J. AGUIRRE**

## NEWS RELEASE

**FOR IMMEDIATE RELEASE: February 22, 2005**

**Contact: Maria Velasquez, Communications Director: (619) 235-5725** (pager & voicemail) [mvelasquez@sanidiego.gov](mailto:mvelasquez@sanidiego.gov)

### **CITY ATTORNEY MICHAEL AGUIRRE'S LEGAL ACTION PLAN TO ADDRESS CITY'S FINANCIAL CONDITION** Memorandum to Mayor and City Council delivered on February 22, 2005

San Diego, CA: City Attorney Michael Aguirre released his legal action plan to address the City's financial condition. The recommendations were provided in a memorandum to the Mayor and City Council. The following is a summary of the City Attorney's 8 recommendations:

**Recommendation No. 1:** That the Mayor and City Council conditionally accept on behalf of the City of San Diego the materials and findings contained in San Diego City Attorney's First and Second Interim Reports.

**Recommendation No. 2:** That the Mayor, City Council, and outside counsel Vinson & Elkins authorize the San Diego City Attorney to engage in negotiations regarding an offer of compromise to the Securities & Exchange Commission (SEC) on behalf of the City of San Diego.

**Recommendation No. 3:** That the Mayor and City Council authorize the City Attorney to take all legal steps necessary to rescind any and all unlawful pension benefits authorized in violation of either California State Law or the San Diego City Charter.

**Recommendation No. 4:** That the Mayor and City Council authorize the City Attorney to take all legal steps necessary to place the San Diego City Retirement System (SDCERS) in receivership.

**Recommendation No. 5:** That the Mayor and City Council adopt a resolution calling upon the SDCERS and/or the SDCERS receiver to waive attorney-client and closed session confidentiality privileges in order to provide all requested documents, materials, and communications to KPMG, the U.S. Attorney, the SEC, and the City Attorney.

**Recommendation No. 6:** That the Mayor and City Council adopt a resolution calling upon the SDCERS Board to comply with the City Attorney's reinstatement as the legal counsel for SDCERS.

**Recommendation No. 7:** That the Mayor and City Council authorize the City Attorney to prepare ordinances and resolutions necessary for the creation of a City Council Audit Committee.

**Recommendation No. 8:** That the Mayor and City Council authorize the City Attorney to prepare ordinances and resolutions necessary for the creation of a Pension Regulatory Commission to establish related pension regulation reforms.

###

# Exhibit 32

SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SAN DIEGO

SAN DIEGO CITY EMPLOYEES' )

RETIREMENT SYSTEM, by and through )

its Board of Administration, )

Plaintiff, )

-vs-

No. GIC 851286

SAN DIEGO CITY ATTORNEY )

MICHAEL J. AGUIRRE; THE CITY OF )

SAN DIEGO and DOES 1-100, )

Defendants. )

AND OTHER RELATED ACTIONS. )

DIGITAL VIDEO DEPOSITION OF DAVID B. WESCOE

SEPTEMBER 26, 2006

Reported by: Rosalie A. Kramm, CSR #5469, CRR

SAN DIEGO • BEVERLY HILLS



CERTIFIED SHORTHAND REPORTERS

2224 3RD AVENUE  
SAN DIEGO, CA 92101

PHONE. 619.239.0080

FAX. 619.239.0206

TOLL FREE. 800.939.0080

WWW.KRAMM.COM

CERTIFIED COPY

DISK  
ENCLOSED

11:02:27 1 said that.

02:28 2 Q. A public City Council?

11:02:30 3 A. Yes, sir.

11:02:30 4 Q. Anyone else told you that?

11:02:31 5 A. Those are the two actuaries that I've been most

11:02:36 6 in contact. I think that's it.

11:02:38 7 Q. Well, tell us, before San Diego, what public

11:02:42 8 pension plans have you been the administrator for?

11:02:45 9 A. None.

11:02:45 10 Q. None?

11:02:46 11 A. No, sir.

11:02:57 12 Q. Tell us which pension plans you've worked for.

03:00 13 A. None.

11:03:05 14 Q. Tell us which pension plans you've represented.

11:03:08 15 A. None.

11:03:14 16 Q. Tell us which pension plans you've advised.

11:03:16 17 A. None.

11:03:31 18 Q. Tell us which pension plans you've consulted

11:03:33 19 with.

11:03:34 20 A. None.

11:03:59 21 Q. Did you tell the SDCERS Pension Board that you

11:04:02 22 had never been a plan administrator, you had never

11:04:05 23 advised, you'd never consulted, you'd never represented

11:04:09 24 a pension plan prior to your being hired?

04:12 25 A. I --

11:04:12 1 MR. VITEK: Just a moment. I object to the  
11:04:14 2 question as not being relevant to the subject matter or  
11:04:17 3 reasonably calculated to lead to the discovery of  
11:04:17 4 admissible evidence. I thought that it had to do with  
11:04:23 5 calculations of underfunding, but we've gone way beyond  
11:04:26 6 that, and I'm not going to let you answer the question.  
11:04:28 7 Don't answer it.  
11:04:29 8 MR. AGUIRRE: Well, it has to do with  
11:04:31 9 credibility.  
11:04:32 10 MR. VITEK: Go ahead. Don't answer it.  
11:04:39 11 MR. AGUIRRE: Let's take a break. Okay?  
11:04:41 12 THE VIDEOGRAPHER: Off the record at 11:04 a.m.  
11:08:50 13 (Recess taken from 11:04 to 11:09.)  
11:09:03 14 THE VIDEOGRAPHER: We're back on the record at  
11:09:03 15 11:09 a.m.  
11:09:07 16 MR. AGUIRRE: Let me show you a copy of  
11:09:09 17 Exhibit 433.  
11:09:10 18 MR. VITEK: Let me take a look at it first,  
11:09:12 19 please.  
11:09:13 20 MR. AGUIRRE: Actually, if you want to take  
11:09:15 21 that one --  
11:09:15 22 (Exhibit 433 was marked for identification.)  
11:09:17 23 MR. VITEK: Thanks. Great. Thank you.  
11:09:23 24 MR. AGUIRRE: And while you're looking at that,  
11:09:24 25 I'm going to mark 434, which is an excerpt from the

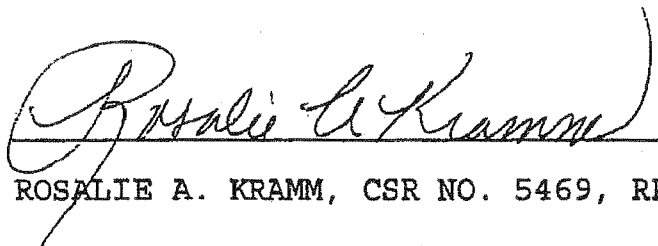
1 COUNTY OF SAN DIEGO, )  
2 STATE OF CALIFORNIA, )  
3

4 I, Rosalie A. Kramm, Certified Shorthand Reporter  
5 licensed in the State of California, License No. 5469,  
6 hereby certify that the deponent was by me first duly  
7 sworn and the foregoing testimony was reported by me and  
8 was thereafter transcribed with Computer-Aided  
9 Transcription; that the foregoing is a full, complete,  
10 and true record of said proceeding.

11 I further certify that I am not of counsel or  
12 attorney for either or any of the parties in the  
13 foregoing proceeding and caption named or in any way  
14 interested in the outcome of the cause in said caption.

15 The dismantling, unsealing, or unbinding of the  
16 original transcript will render the reporter's  
17 certificates null and void.

18 In witness whereof, I have hereunto set my hand  
19 this day: October 2, 2006.

20  
21   
22 ROSALIE A. KRAMM, CSR NO. 5469, RPR, CRR  
23  
24  
25



# Exhibit 33

**INTERIM REPORT NO. 8**

**REPORT ON KROLL'S BREACH OF LEGAL  
DUTIES OWED TO THE CITY OF SAN DIEGO**

**REPORT OF THE  
SAN DIEGO CITY ATTORNEY**

**MICHAEL J. AGUIRRE**

**OFFICE OF  
THE CITY ATTORNEY  
CITY OF SAN DIEGO**

**1200 THIRD AVENUE, SUITE 1620  
SAN DIEGO, CALIFORNIA 92101-4178  
TELEPHONE: (619) 236-6220**

**13 APRIL 2006**

## **TABLE OF CONTENTS**

<b><u>CHAPTER</u></b>	<b><u>PAGE NUMBER</u></b>
I. INTRODUCTION.....	2
II. BACKGROUND.....	3
III. AUDIT COMMITTEE DUTIES.....	9
IV. KROLL HAS BREACHED LEGAL DUTIES.....	11
V. KROLL INVOICES BREACHED INTERNAL CONTROLS.....	20
VI. KROLL COMPROMISED ITS INDEPENDENCE .....	29
A. Kroll and Vinson & Elkins.....	30
B. Kroll and City Officials.....	34
C. Kroll and the Union-Tribune.....	38
D. Kroll and KPMG.....	43
VII. KROLL EXCUSES FOR DELAY NOT VALID .....	45
VIII. CONCLUSION.....	49

## I.

### INTRODUCTION

The San Diego City Attorney is issuing this Eighth Interim Report related to alleged unlawful acts and improper activities associated with the City of San Diego's pension financial crisis. In previous Interim Reports the San Diego City Attorney has addressed the substance of the alleged illegal acts and improper activities. In this, the Eighth Interim Report the City Attorney discusses the role of Kroll Inc.

On 14 February 2005, the San Diego City Council hired former SEC Chairman Arthur Levitt to review two conflicting investigative reports addressing alleged illegal activities by San Diego City officials involving the City of San Diego's pension plan. One report was prepared by the City Attorney Michael J. Aguirre and it concluded that there was substantial evidence that members of the San Diego City Council had knowingly or recklessly violated the civil fraud provisions of federal securities laws. The other report was prepared by the City's outside counsel, Vinson & Elkins. In its report Vinson & Elkins found no wrongdoing by City Council members.

Mr. Levitt was retained, by the City through Kroll, Inc., ("Kroll"), a risk management firm. Mr. Levitt created a three member team consisting of himself, former SEC accountant Lynn Turner, and attorney Troy Dahlberg.

Mr. Levitt's charge was to reconcile separate investigative reports into alleged illegal acts by City officials involving the City's pension plan and other financial disclosure practices. The engagement was intended to satisfy KPMG, the City's outside auditor that an appropriate "illegal acts" investigation was conducted by the City in conformance with the applicable auditing standards.

In this report the City Attorney now concludes that Kroll and its partner Willkie Farr & Gallagher LLP ("Willkie Farr") have breached legal duties they owed to the City of San Diego ("City"). Kroll and Willkie Farr's breach of legal duties owed to the City of San Diego has been the proximate cause of substantial damages suffered by the City of San Diego.

In this report the City Attorney documents that Kroll and Willkie Farr have:

- Breached contractual and professional duties to the City of San Diego, by failing to perform or performing below the applicable standard of care;
- Failed to complete their work specified deadlines;
- Expanded the scope and cost of their work without Council authorization;
- Violated City billing guidelines by failing to support their billings with proper documentation;
- Failed to act independently;
- In the case of Kroll, engaged in unauthorized lobbying activities; and
- Used undue influence to pressure the City to pay the firms over \$20 million.

It is the recommendation of the City Attorney's Office that the City of San Diego immediately terminate its engagement with Kroll and Willkie Farr and that it initiate litigation to recover financial losses to the City.

## **II.**

### **BACKGROUND**

The City of San Diego is in the throes of one of the most daunting political and financial crises in its history. The City is currently facing a pension funding deficit of between \$1.4 billion and \$2 billion in its pension system as a result of a number of financial factors including, but not limited to, the creation of illegal retirement benefits.

The granting of these benefits is the result of two contingent, quid pro quo arrangements between the San Diego City Council and the San Diego City Employees' Retirement System (SDCERS). The potential magnitude of the pension debt, or unfunded liability, was discovered in late 2001 and information about the growing nature of the shortfall was communicated to SDCERS and some City officials but hidden from the public.<sup>1</sup>

---

<sup>1</sup> 3 December 2001 E-mail from Assistant City Auditor and SDCERS Board Trustee Teri Webster to SDCERS Administrator Lawrence Grissom and carbon-copied to City Human

The City filed voluntary corrections to its Certified Annual Financial Report (“CAFR”) disclosures on 27 January 2004 calling attention to debts that were omitted from previously released financial disclosures.<sup>2</sup> Meanwhile the City has not issued a Comprehensive Annual Financial Report (CAFR), or audit, since fiscal year 2002. The lack of a financial audit has prevented the City from borrowing money in the public markets.

The filing of the voluntary disclosures raised concerns with the U.S. Securities and Exchange Commission (“SEC”) and the U.S Attorney’s Office (“U.S. Attorney”). Both federal agencies launched investigations of the City. The SEC and the U.S. Attorney issued document requests to the City in July 2004.

The City retained Houston-based law firm Vinson & Elkins L.L.P. (“Vinson & Elkins”) on 18 February 2004 to undertake an inquiry into the City’s financial disclosure practices.<sup>3</sup> The firm was to investigate the City’s financial control structure to identify any misconduct and practices that allowed the disclosure failures to occur.

Vinson & Elkins was tasked with working with accounting firm KPMG to examine the old financial data, ensure that all issues related to receiving an unqualified audit were addressed and to identify and implement policies to ensure the errors do not occur in the future. Both Vinson & Elkins and KPMG failed to agree on a work plan sufficient to satisfy applicable audit requirements.

After discovering a series of errors by the auditing firm Caporicci & Larson on the 2002 CAFR, the City severed the business relationship with that firm. Although Caporicci & Larson had completed an audit for fiscal year 2003, the City hired KPMG to, in effect, re-do the 2003 audit.<sup>4</sup> KPMG

---

Resources Director and SDCERS Board Trustee Cathy Lexin. Re: earnings EEEK!  
(Exhibit 1)

<sup>2</sup> Municipal Secondary Market Disclosure (Exhibit 2)

<sup>3</sup> 18 February 2004 letter from Vinson & Elkins Partner Paul S. Maco to former City Attorney Casey Gwinn. (Exhibit 3)

<sup>4</sup> 13 April 2004 letter from KPMG Partner Steven DeVetter to Lisa Irvine, director of the City’s Financial Management Department. (Exhibit 4)

issued a letter to the City on 9 August 2004 stating that the investigation being performed by Vinson & Elkins must include an analysis of whether any laws were violated.<sup>5</sup>

In the 9 August 2004 letter, KPMG Partner Steven DeVetter specifically asked Vinson & Elkins to answer a series of questions that included, "Did the SDCERS Board breach their fiduciary duty by allowing the City to underfund the plan in exchange for additional benefits for current employees and could this action have been in violation of any laws?...Did the City violate the City Charter by failing to fund its retirement plan as required by the City Charter?...Did the SDCERS Board and/or the City violate the California Constitution by allowing the City to intentionally underfund the plan?" KPMG also included a copy of the American Institute of Certified Public Accountants AU § 317.<sup>6</sup>

Vinson & Elkins issued their report titled "Report on Investigation: The City of San Diego, California's Disclosures of Obligation to Fund the San Diego City Employees' Retirement System and Related Disclosure Practices," on 16 September 2004.<sup>7</sup> The report outlined two different agreements between the City Council and the SDCERS Board of Administrations ("Board") as the primary sources of the pension deficit.

These agreements provided for the SDCERS Board to accept underfunding of the retirement system in exchange for the City Council agreement to grant enhanced unfunded pension benefits for City employees. The first deal, commonly referred to as Manager's Proposal I, was approved in 1996. The second deal, called Manager's Proposal II, was approved in 2002. The report found that a series of disclosure violations occurred. The report, however, made no mention of any individual violations of law by

---

<sup>5</sup> 9 August 2004 letter from KPMG Partner Steven DeVetter to Assistant City Attorney Les Girard. Re: Investigation. (Exhibit 5)

<sup>6</sup> American Institute of Certified Public Accountants AU § 317. Illegal Acts by Clients (Exhibit 6)

<sup>7</sup> 16 September 2004. Vinson & Elkins: Report on Investigations. The City of San Diego, California's Disclosures of Obligations to Fund the San Diego City Employees' Retirement System and Related Disclosure Practices 1996-2004 with Recommended Procedures and Changes to the Municipal Code. (Exhibit 7)

City or SDCERS officials. In fact, no assessment of potentially illegal acts was made by Vinson & Elkins during its investigation.

KPMG issued a letter to the City on 11 October 2004 which stated that the report was insufficient to meet professional auditing standards and that an illegal acts analysis was necessary for the audit to be completed. DeVetter wrote,

[W]e do not believe that the City of San Diego (“City”) has conducted an adequate investigation in order to conclude that likely illegal acts have not occurred, or that appropriate remedial action has been taken. Such an investigation is necessary in order for an auditor to complete an audit in accordance with generally accepted auditing standards and *Government Auditing Standards*.<sup>8</sup>

Importantly, the letter quoted additional language from the American Institute of Certified Public Accountants regarding auditing standards. The language was meant to serve as a guideline for a future investigation.

Vinson & Elkins Partner Paul Maco issued a response to Assistant City Attorney Leslie Girard on 28 October 2004, stating that KPMG “fail[ed] to provide any practical guidance as to what additional investigative procedures [KPMG] would find satisfactory” for the completion of the 16 September 2004 report.<sup>9</sup>

KPMG reasserted the need for an illegal acts investigation in a 29 October 2004 letter to former Mayor Dick Murphy.<sup>10</sup> DeVetter, in the letter, explicitly asked the City to contract a firm other than Vinson & Elkins to complete this work.

---

<sup>8</sup> 11 October 2004. Letter from Steven G. DeVetter to Leslie J. Girard. Re: City of San Diego Fiscal Year 2003 Audit (Exhibit 8)

<sup>9</sup> 28 October 2004. Letter from Vinson & Elkins Partner Paul Maco to Assistant City Attorney Leslie Girard. Re: Additional Investigation. (Exhibit 9)

<sup>10</sup> 29 October 2004. Letter from KPMG Partner Steven DeVetter to Assistant City Attorney Leslie Girard. Re: Follow-up from meeting on August 27, 2004. (Exhibit 10)



“If the City is prepared to proceed with an appropriate investigation, then we urge you to consider retaining counsel other than V&E [Vinson & Elkins] to do so. The positions asserted in, and oppositional tone of, Mr. Maco’s letter raises questions about V&E’s willingness or ability in these circumstances to complete the investigation of, and reach conclusion on, the audit-critical questions posed in our prior oral and written communications and to do so with an objective and independent manner.”<sup>11</sup>

Despite the specific request, the City extended the contract with Vinson & Elkins to complete the investigation and to provide its analysis in a second report.

A new City Attorney, Michael J. Aguirre, was elected on 2 November 2004 and took office on 6 December 2004. The new City Attorney announced the City Attorney’s Office would conduct an independent illegal acts investigation under applicable auditing standards.<sup>12</sup> The City Attorney subsequently released a series of Interim Reports outlining alleged illegal acts that occurred in the approval of the Manager’s Proposal I in 1996 and Manager’s Proposal II in 2002. The first Interim Report was issued on 14 January 2005<sup>13</sup> and the second Interim Report was issued on 9 February 2005.<sup>14</sup>

The City Council then hired Los Angeles-based forensic accounting firm, Kroll Inc., to sort out the findings of Vinson & Elkins and the City Attorney. Troy Dahlberg, managing director of Kroll, issued a letter of

---

<sup>11</sup> 29 October 2004. Letter from KPMG Partner Steven DeVetter to Assistant City Attorney Leslie Girard. Re: Follow-up from meeting on August 27, 2004. (Exhibit 10)

<sup>12</sup> 9 December 2004. Press release from the office of City Attorney Michael Aguirre. “Statement from City Attorney Michael J. Aguirre: Financial Disclosure Practices Investigation, and Decision Not to Join San Diego’s Retirement System.” (Exhibit 11)

<sup>13</sup> 14 January 2005. Interim Report No. 1 Regarding Possible Abuse, Fraud, and Illegal Acts by San Diego City Officials and Employees. Report of the San Diego City Attorney Michael J. Aguirre. (Exhibit 12)

<sup>14</sup> 9 February 2005. Interim Report No. 2 Regarding Possible Abuse, Fraud, and Illegal Acts by San Diego City Officials and Employees. Report of the San Diego City Attorney Michael J. Aguirre. (Exhibit 13)

engagement to the City on 10 February 2005. The Kroll scope of services were stated as follows:

“The City has requested that Kroll (1) receive, review and evaluate the findings of the investigations by VINSON & ELKINS and the City Attorney. The City has also requested Kroll provide consulting assistance in assessing internal control deficiencies affecting matters discussed in the investigation reports.”<sup>15</sup>

The letter also conditions the performance of Kroll’s responsibilities intended to satisfy the needs of KPMG. Kroll specifically requested unfettered access to personnel and documents of the City, SDCERS, Vinson & Elkins, the City Attorney, and other potentially involved parties.<sup>16</sup> Kroll also retained the authority to hire legal counsel for representation at the City’s expense. The City Council approved the Kroll contract at its 14 February 2005 meeting.<sup>17</sup>

The Kroll team is headed up by Troy Dahlberg who is billed at \$450 an hour, Lynn Turner at \$750 an hour, and Arthur Levitt at \$900 an hour. The remainder of the Kroll associates working on the project bill at rates ranging from \$125 to \$750 per hour.<sup>18</sup> At the 14 February 2005 televised City Council meeting, Lynn Turner, a consultant for Kroll, explained that Kroll would take the reports issued by the City Attorney and Vinson & Elkins, compare the data and findings, and issue its findings to KPMG.<sup>19</sup>

---

<sup>15</sup> 10 February 2005. Letter from Troy Dahlberg to Mayor Richard Murphy and San Diego City Council. Re: Independent Services for the City of San Diego. (Exhibit 14)

<sup>16</sup> 10 February 2005 letter from Troy Dahlberg, managing director of Kroll, to Mayor Richard Murphy and San Diego City Council. Re: Independent Services for the City of San Diego. (Exhibit 14)

<sup>17</sup> 14 February 2005 meeting of the San Diego City Council. (Exhibit 15)

<sup>18</sup> 10 February 2005 letter from Troy Dahlberg to Mayor Richard Murphy and San Diego City Council. Re: Independent Services for the City of San Diego. P 4. (Exhibit 14)

<sup>19</sup> Transcript of Lynn Turner’s presentation at the 14 February 2005 meeting of the San Diego City Council. (Exhibit 16)

Kroll also outlined a second phase of their work: consulting with City personnel to establish internal controls to ensure that financial transactions are identified and reported properly in financial reports issued by the City. Kroll stated that this part of their engagement with the City would begin upon completion of its analysis of the work of Vinson & Elkins and the City Attorney.

Turner appeared again at the televised City Council meeting on 8 March 2005. At the meeting the City Council authorized representatives of Kroll to establish "the Audit Committee of the City as contemplated by the Sarbanes-Oxley Act of 2002" as discussed below.<sup>20</sup> The majority of City Council members at the meeting also agreed to sign a letter to cease discussing investigative matters with the press. Council member Donna Frye and City Attorney Michael J. Aguirre declined to sign the letter. Kroll later brought on the law firm of Willkie Farr & Gallagher ("Willie Farr") to work with Kroll.<sup>21</sup>

### **III.**

#### **AUDIT COMMITTEE DUTIES**

The format and function of an Audit Committee for a municipality has been laid out and identified by the Government Finance Officers Association (GFOA), a professional association of state/provincial and local finance officers in the United States and Canada, and has served the public finance profession since 1906. In applying the standards and practices, the GFOA utilizes accounting and disclosure standards applied to private corporate business in the Sarbanes-Oxley Act of 2002.

The GFOA specifies that three groups are principally responsible for the financial reporting of a municipal body: "the governing body, financial

---

<sup>20</sup> 8 March 2005 meeting minutes of the San Diego City Council. Resolution Number R-300203 (Exhibit 17)

<sup>21</sup> 19 April 2005 letter from Willkie Farr & Gallagher to Kroll Inc. Re: Terms of Engagement as Counsel to the Audit Committee of the City of San Diego. (Exhibit 18)

management, and the independent auditors.”<sup>22</sup> The GFOA states that the governing body must maintain its ability to oversee the process.

“Of these three, the governing body must be seen as ‘first among equals’ because of its unique position as the ultimate monitor of the financial reporting process.”

The GFOA states that the governing body:

“[I]nclude any other elected officials (e.g., county auditor, city controller) with legal responsibility for overseeing financial reporting, internal control, and auditing, provided they do *not* exercise managerial responsibilities within the scope of the audit. The term ‘governing body’ also is intended to encompass appointed bodies such as pension boards.”

The GFOA goes on to state that the members of an audit committee “should be members of the governing body. To ensure the committee’s independence and effectiveness, no governing body member who exercises managerial responsibilities that fall within the scope of the audit should serve as a member of the audit committee.”

Once established by the governing body of a municipality, the purpose of the Audit Committee is to provide independent oversight of the completion of a CAFR to ensure that accurate information is disclosed in financial reports. The audit committee should submit one written report annually to the governing body. The GFOA states:

The audit committee should present annually to the full governing body a written report of how it has discharged its duties and met its responsibilities. It is further recommended that this report be made public and be accompanied by the audit committee’s charter or other establishing documentation.<sup>23</sup>

---

<sup>22</sup> Government Finance Officers Association. “Recommended Practices: Audit Committees (1997, 2002, and 2006) (CAAFR). (Exhibit 106)

<sup>23</sup> Government Finance Officers Association. “Recommended Practices: Audit Committees (1997, 2002, and 2006) (CAAFR). (Exhibit 106)

This interim report will illustrate that the formation of the audit committee is not in compliance with standards set for by the GFOA. The evidence presented below will also show that Kroll and Willkie Farr have failed to complete their responsibilities in acting as an audit committee as prescribed by the GFOA.

#### IV.

#### **KROLL HAS BREACHED LEGAL DUTIES**

As stated above, Kroll was hired by the City of San Diego to conduct an independent comparison and evaluation of the reports issued by the City Attorney and Vinson & Elkins.

Almost immediately, Kroll and Vinson & Elkins began working together. On 6 May 2005, Kroll issued a letter to City Manager P. Lamont Ewell explaining that materials compiled by Vinson & Elkins in the course of its investigations were useful. The letter was vague, however, as to whether Vinson & Elkins would issue a second report. In the letter, Kroll continued to stress their independence despite working with Vinson & Elkins.<sup>24</sup>

Questions have been raised as to whether or not Vinson & Elkins' work program will result in another report from that firm. The independent auditors have not specifically requested that from the Audit Committee.<sup>25</sup>

At this point, the duties of Kroll appeared to have changed from analyzing a series of reports from Vinson & Elkins and the City Attorney to conducting another investigation and issuing a completely separate report. There were, however, no amendments made to the Kroll contract to reflect the revised scope of work at that time. It is also important to note that the letter illustrates that Kroll appeared to be managing the work of Vinson & Elkins – a significant departure from Kroll's contractual obligation to analyze Vinson & Elkins final investigative product.

---

<sup>24</sup> 6 May 2005 letter from Troy Dahlberg, managing director of Kroll Inc., to City Manager P. Lamont Ewell. Re: Audit Committee – Investigation Status. (Exhibit 19)

<sup>25</sup> 6 May 2005 letter from Troy Dahlberg, managing director of Kroll Inc., to City Manager P. Lamont Ewell. Re: Audit Committee – Investigation Status. (Exhibit 19)

Kroll sent a letter to the City Council on 10 June 2005 further outlining its relationship with Vinson & Elkins.<sup>26</sup> Dahlberg wrote that the Kroll team had been reviewing the work plan laid out by Vinson & Elkins, examining documents collected, and would “provide V&E guidance as to the structure and format for presenting their findings and work product to KPMG.” The letter also stated that Vinson & Elkins will issue a “summary memorandum” which will serve as a second report.<sup>27</sup>

Kroll also unilaterally elected to assert control over the production of documents in response to a series of subpoenas issued by the U.S. Attorney’s Office and the SEC.<sup>28</sup> Working in conjunction with Kroll, the Mayor and City Manager issued a memo on 10 June 2005 requesting documents from thousands of employees across the City bureaucracy. Over the next few months, a monumental effort by City staff – many of whom were not involved in the matter under investigation or who were not employed by the City at the time of the events – produced more than one million paper documents.<sup>29</sup>

Representatives of Kroll appeared before the City Council on 14 June 2005 to provide a status report on their work. At the meeting, Mr. Levitt said that the work was being delayed because the SDCERS Board of Directors had failed to waive the attorney-client privilege on documents Kroll needed to complete their investigation.<sup>30</sup>

Meanwhile, concerns were growing in the City about the scope of documents that were requested by Kroll and the Mayor and City Manager’s

---

<sup>26</sup> 10 June 2005 letter from Troy Dahlberg, managing director at Kroll, to Mayor Richard Murphy. Re: Audit Committee – Investigation Status Update. (Exhibit 20)

<sup>27</sup> 10 June 2005 letter from Troy Dahlberg, managing director at Kroll, to Mayor Richard Murphy. Re: Audit Committee – Investigation Status Update. (Exhibit 20)

<sup>28</sup> 10 June 2005 letter from Troy Dahlberg, managing director at Kroll, to Mayor Richard Murphy. Re: Audit Committee – Investigation Status Update. (Exhibit 20)

<sup>29</sup> 10 June 2005 memo from Mayor Richard Murphy and City Manager P. Lamont Ewell to all City employees, City Council, and San Diego City Retirement System. (Exhibit 21)

<sup>30</sup> Transcript of Arthur Levitt’s testimony at the 14 June 2005 meeting of the San Diego City Council. (Exhibit 22)

letter of 10 June 2005. The City's Chief Information Officer, Rey Arellano, addressed that anxiety in a letter to Lynn Turner on 23 June 2005.<sup>31</sup> Arellano wrote,

The questions generally surround the specific process to be used to conduct a search of electronic files and e-mail, whether search terms will be provided, why every City employee regardless of how far removed they may be from any of the issues needs to respond, and various questions specific to some departments' unique circumstances.<sup>32</sup>

Kroll, however, did not pare down the request to City employees and continued to collect boxes of documents – many of which had already been collected in response to subpoenas from federal investigators.

On 1 August 2005, Troy Dahlberg appeared back before the televised City Council meeting to request the Council waive the attorney privilege on documents that Vinson & Elkins obtained during its investigation. During Dahlberg's presentation, Councilmember Donna Frye asked a series of questions about the documents that were being waived and to whom they would be presented. Dahlberg said that the information was going to be presented to the SEC and KPMG.

In response to council member Frye's questions, Dahlberg also stated that Kroll possessed in its ninth floor City Hall office a memorandum from Vinson & Elkins explaining the findings of their second investigation.<sup>33</sup> Both Frye and the City Attorney criticized the firms for not alerting the City Council to the existence of the draft Vinson & Elkins memorandum and requested a copy. Dahlberg reluctantly provided a copy of the 116-page report to the Council and City Attorney.<sup>34</sup> The memorandum, released to the

---

<sup>31</sup> 23 June 2005 letter from Rey Arellano, chief information officer for the City of San Diego to Lynn Turner. (Exhibit 19)

<sup>32</sup> 23 June 2005 letter from Rey Arellano, chief information officer for the City of San Diego to Lynn Turner. (Exhibit 23)

<sup>33</sup> Transcript of the 1 August 2005 meeting of the San Diego City Council. (Exhibit 24)

<sup>34</sup> Vinson & Elkins draft report titled "Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals". 15 July 2005 (Exhibit 25)

public in the following days, found that the City failed to adhere to Generally Accepted Accounting Principles ("GAAP"). The report, however, cited no intentional wrongdoing or violations of law.

By this time, the City Attorney had released six Interim Reports outlining alleged illegal acts surrounding Manager's Proposal I and II. The six reports contained footnotes and evidence to substantiate each claim and contained extensive appendices containing all footnoted documents.

Kroll now had the essential materials necessary to complete the work detailed in its 10 February 2005 engagement letter with the City. To date, no such work product has been produced. Kroll's failure to compare the two reports and report its findings to KPMG represents a breach in the firm's contractual responsibility to the City. As a result of this failure, KPMG has not issued its 2003 audit opinion and the City still cannot access the public capital markets.

Instead, Kroll continued to claim that the City Attorney had not been responsive in turning over relevant documents and methods used in the research and writing of the six Interim Reports. Dahlberg stressed this issue in status update letters to the City Council on 6 May 2005 and 10 June 2005.

On 5 August 2005, the City Attorney issued a 41-page letter listing every document included in the Interim Reports.<sup>35</sup> The letter stated that the relevant documents for the investigation were disclosed when the reports were issued and invited representatives of Kroll and Willkie Farr to identify any further needs.

Kroll and a team of attorneys from Willkie Farr appeared before the City Council on 9 August 2005 to present another status report on the progress of their work. Levitt told the Council that the investigation could not be completed without the waiver of the attorney client privilege from SDCERS. Levitt said,

In just five months of work, we have encountered a refusal by the pension board to make available to the U.S. Attorney, the SEC, or the Audit Committee documents critical to the

---

<sup>35</sup> 5 August 2005 letter from City Attorney Michael Aguirre to Troy Dahlberg, managing director of Kroll Inc. Re: Audit Committee of the City of San Diego. (Exhibit 26)



ascertainment of the truth and critical to the completion of an investigation satisfactory to both us and the auditor.<sup>36</sup>

Levitt added that he anticipated Kroll's investigation would be completed by the end of calendar year 2005. At that meeting Levitt again claimed that all documents had not been turned over by the City Attorney. However, when asked by the City Attorney if Levitt and Dahlberg had examined the reports and the supporting documents, both said they had not reviewed all the material to ensure that all relevant information had been provided.<sup>37</sup>

Later in August 2005, a federal court ordered SDCERS to release more than 60,000 documents that had been protected by the attorney-client privilege.<sup>38</sup> Numerous documents were discovered that corroborated the assertion that a quid pro quo arrangement took place between the City and SDCERS in the approval of Manager's Proposal II in 2002. This information was widely reported by broadcast and print media organizations.

On 15 September 2005 the City Attorney issued an Interim Report focusing on illegal acts in sewer rate overcharges. The report concluded that, "there is substantial evidence consistent with a finding that City officials did attempt to conceal, and did conceal, material information regarding the wastewater system's noncompliant rate structure and the potential risk of forfeiture of Federal grants and State loans."<sup>39</sup>

Representatives of Kroll and Willkie Farr again appeared before the City Council on 26 September 2005 to provide another status report. Benito Romano, a Willkie Farr partner in charge of that firm's engagement, said that the new documents from SDCERS and an additional 20 to 30 boxes of

---

<sup>36</sup> Transcription of Arthur Levitt's comments at the 9 August 2005 meeting of the San Diego City Council. (Exhibit 27)

<sup>37</sup> Transcription of the 9 August 2005 meeting of the San Diego City Council. (Exhibit 28)

<sup>38</sup> Donohue, Andrew. "Pension Documents to Be Turned Over to Feds". *Voice of San Diego*. 23 August 2005. (Exhibit 29)

<sup>39</sup> 15 September 2005. "Wastewater Interim Report No. 1: City of San Diego Officials' Failure to Disclose Material Facts in Connection With The Offer and Sale of Wastewater Bonds and Related Improper Activity." (Exhibit 30)

documents from City Council members all needed to be properly analyzed before Kroll and Willkie Farr could complete their work.

Romano also said that the staff of the SEC asked Kroll and Willkie Farr to look into possible illegal acts concerning sewer rate overcharges paid by residents of the City. He said, "We are giving the SEC our unvarnished views about whatever the evidence shows, as we would in the pension area." Romano said that the work would be completed by the end of the 2005 calendar year.<sup>40</sup>

Members of Kroll and Willkie Farr met with representatives of the City Attorney's office on 21 September 2005 to discuss the investigation. At the meeting, Romano and Dahlberg stated that work on a draft of Kroll and Willkie Farr's investigative report would commence soon. On 4 October 2005, Assistant City Attorney Anita Noone wrote a letter to representatives of Kroll and Willkie Farr to request notification when the draft had begun.<sup>41</sup> A reply from representatives of Kroll and Willkie Farr was never received.

On 25 October 2005, Dahlberg sent a letter to notify the City that the investigation and report would not be completed until mid-March due to a series of new problems.<sup>42</sup> The letter stated that more documents had been produced by City employees in response to the 10 June 2005 request letter than was anticipated. The letter stated, "City Employees provided approximately 400 boxes of documents in response to the 10 June 2005 memo.

The volume of records is far greater than what was initially expected. Review of this information will require more time than was previously anticipated."<sup>43</sup> In effect, Kroll and Willkie Farr ignored the plea from

---

<sup>40</sup> Transcription of Benito Romano's testimony at the 9 August 2005 meeting of the San Diego City Council. (Exhibit 31)

<sup>41</sup> 4 October 2005. Letter from Assistant City Attorney Anita Noone to Benito Romano and Jeffery Klein. Carbon-copied to Troy Dahlberg, Lynn Turner, and Michael Aguirre. (Exhibit 32)

<sup>42</sup> 25 October 2005 letter from Arthur Levitt, Lynn Turner, and Troy Dahlberg to Acting Mayor Toni Atkins. Re: Audit Committee – Investigation Status Update. (Exhibit 33)

<sup>43</sup> 25 October 2005 letter from Arthur Levitt, Lynn Turner, and Troy Dahlberg to Acting Mayor Toni Atkins. Re: Audit Committee – Investigation Status Update. (Exhibit 33)

Arellano to pare down the scope of the document request, and then claimed that the resulting volume would delay the completion of the report.

The letter also stated that numerous problems had arisen from a computer program that Vinson & Elkins had used to catalogue documents in a database. As a result, Kroll and Willkie Farr would need to hire more consultants to fix this problem and create a second electronic database to store documents.<sup>44</sup>

Representatives of Kroll and Willkie Farr appeared before the televised City Council meeting on 1 November 2005 and received additional funding for its work and for the work of consultants to analyze and build the new database.<sup>45</sup> At this point in November 2005, Kroll had worked for 8 months and, to the knowledge of the City Attorney, delivered no report of its findings to the City.

On 6 January 2006 the U.S. Attorney's Office announced its indictments of three former trustees of the San Diego City Employee's Retirement System: Ron Saathoff, president of the San Diego Firefighters Association Local 145; Cathy Lexin, former Human Resources Director for the City; and Terri Webster, former assistant auditor and comptroller for the City. The indictments also named former SDCERS Administrator Lawrence Grissom, and Lorraine Chapin, general counsel at SDCERS.<sup>46</sup>

In a local newspaper, Dahlberg told a reporter that the action by the U.S. Attorney would lead to another expansion of the scope of Kroll's

---

<sup>44</sup> 25 October 2005 letter from Arthur Levitt, Lynn Turner, and Troy Dahlberg to Acting Mayor Toni Atkins. Re: Audit Committee – Investigation Status Update. (Exhibit 33)

<sup>45</sup> 1 November 2005 meeting minutes of the San Diego City Council. (Exhibit 34)

<sup>46</sup> 6 January 2006. United States District Court Southern District of California January 2004 Grand Jury: United States of America, Plaintiff, v. Ronald Saathoff (1), Cathy Lexin (2), Teresa Webster (3), Lawrence Grissom (4), Lorraine Chapin (5), Defendants. Criminal Case No. 06CR0043BEN. Indictment: Title 18, U.S.C., Sec. 371 – Conspiracy to Commit Wire and Mail Fraud; Title 18, U.S.C., Secs. 1343 and 1346 – Wire Fraud; Title 18, U.S.C., Secs. 1341 and 1346 – Mail Fraud; Title 18, U.S.C., Sec. 2 – Aiding and Abetting. (Exhibit 35)

investigation.<sup>47</sup> According to the media report, Dahlberg said that grand jury allegations must be reviewed, but that Kroll and Willkie Farr would not have access to the interviews conducted by federal investigators.

Dahlberg said, “We are not privy to the evidence that's gathered by any of the governmental agencies...It's on our shoulders to go out and do our own investigation.”<sup>48</sup> Dahlberg also added that Kroll had not received all of the e-mails from Chapin and Grissom from SDCERS despite the organization's waiver of the attorney client privilege, according to the report.<sup>49</sup>

Soon thereafter, Kroll leaked information to the press that more money would be needed to complete its investigation.<sup>50</sup> In a 20 December 2005 report in the *Voice of San Diego*, Dahlberg said that Kroll would need an additional \$9 million to \$11 million to finish the investigation. Dahlberg said that the City Council allowed the company to spend money as it saw fit under the auspices of the Sarbanes-Oxley Act. Dahlberg was quoted in the report saying, “We wanted that empowerment so that they wouldn't interfere with the investigation improperly.”<sup>51</sup> The Dahlberg estimate would prove to be too low.

Lynn Turner issued a letter to Mayor Jerry Sanders and the City Council on 13 January 2006 stating that the “professional fees for services yet incurred, to complete the remaining work necessary for the investigation and issuance of our work are in the range of approximately \$7 million to \$10

---

<sup>47</sup> Hall, Matthew T. “City's financial picture worse than ever, Sanders says.” *San Diego Union-Tribune*. 7 January 2006. (Exhibit 36)

<sup>48</sup> Hall, Matthew T. “City's financial picture worse than ever, Sanders says.” *San Diego Union-Tribune*. 7 January 2006. (Exhibit 36)

<sup>49</sup> Hall, Matthew T. “City's financial picture worse than ever, Sanders says.” *San Diego Union-Tribune*. 7 January 2006. (Exhibit 36)

<sup>50</sup> Donohue, Andrew. “Not Requesting, Insisting.” *Voice of San Diego*. 20 December 2005. (Exhibit 37)

<sup>51</sup> Donohue, Andrew. “Not Requesting, Insisting.” *Voice of San Diego*. 20 December 2005. (Exhibit 37)

million.”<sup>52</sup> Turner added, “In addition, the draft resolution notes there is also approximately \$3.3 million in billed and unbilled services that have not been paid at this time.”<sup>53</sup>

Turner concluded in his 13 January 2006 letter with what appeared to be a veiled threat, “If the Council determines not to approve the funding, we assume that will be consistent with a decision not to complete the investigation. Of course, the City’s cooperation in completing the work that needs to be done is important.”<sup>54</sup> At the televised San Diego City Council meeting of 17 January 2006, the City Council approved an allocation of \$10 million to Kroll for the completion of the study.<sup>55</sup>

Just two weeks later, the leadership of Kroll and Willkie Farr issued a letter to Mayor Jerry Sanders and Council member Scott Peters on 25 January 2006 requesting an additional \$3.2 million. Dahlberg wrote in the letter that, without the funding the investigation will not be completed.<sup>56</sup> Dahlberg wrote:

We understand the City Council authorized an expenditure of up to \$10 million for the Audit Committee to complete its work, which, as we have noted repeatedly, is an important step in obtaining audited financial statements, restoring the City’s Audit rating and facilitating cooperation with law enforcement. The Audit Committee will do everything it can to complete the investigation in an efficient and timely manner, consistent with its independence and obligation to be thorough. Be advised, however, the authorized level of funding, based on our present

---

<sup>52</sup> 13 January 2006. Letter from Lynn Turner to Mayor Jerry Sanders and Council member Scott Peters. Re: Audit Committee Investigation. (Exhibit 38)

<sup>53</sup> 13 January 2006. Letter from Lynn Turner to Mayor Jerry Sanders and Council member Scott Peters. Re: Audit Committee Investigation. (Exhibit 38)

<sup>54</sup> 13 January 2006. Letter from Lynn Turner to Mayor Jerry Sanders and Council member Scott Peters. Re: Audit Committee Investigation. (Exhibit 38)

<sup>55</sup> 17 January 2006 minutes for regular meeting of the San Diego City Council. (Exhibit 39)

<sup>56</sup> 25 January 2006. Letter from Troy Dahlberg to Mayor Jerry Sanders and Council member Scott Peters. (Exhibit 40)

best estimate, will very likely fall short of the funding required to complete the investigation by as much as approximately \$3.3 million.<sup>57</sup>

The letter did not indicate what work remained to be completed in the investigation and importantly provides no time line as to when the work would be completed.

Kroll and Willkie Farr have not completed their report comparing the work of Vinson & Elkins and the City Attorney. Kroll and Willkie Farr have also failed to complete their investigation or provide a timeline for its completion. The City Attorney finds the failure to complete the comparison of the Vinson & Elkins and the City Attorney's reports to be a breach of contract with the City of San Diego.

The City Attorney issued a seventh Interim Report on 6 December 2005 analyzing the documents released by SDCERS.<sup>58</sup> The report concluded that the SDCERS documents "provides additional evidence that retirement benefits granted by the City Council as part of Manager's Proposal II was part of a quid pro quo arrangement to entice the SDCERS Board to lower the 82.3 percent funding trigger." The report also concluded there is "substantial evidence that officials and trustees of SDCERS violated Government Code 1090 and there is also evidence these officers violated their fiduciary duty to the pension system."

## V.

### **KROLL INVOICES BREACHED INTERNAL CONTROLS**

The American Institute of Certified Public Accountants (AICPA) outlines auditing and professional standards in their Codification of Statements on Auditing Standards. Specifically, AU § 319 specifies the roles and responsibilities of the hiring agency. That section also establishes the standards and a professional code of conduct of auditors and accountants.

---

<sup>57</sup> 25 January 2006. Letter from Troy Dahlberg to Mayor Jerry Sanders and Council member Scott Peters. (Exhibit 40)

<sup>58</sup> 6 December 2005. Interim Report No. 7 – SDCERS Attorney-Client Privilege Documents Released Under Federal Court Order – Report of San Diego City Attorney Michael J. Aguirre. (Exhibit 41)

The City and the consultant are required to ensure that work is being done properly by instituting information and communication standards, and control processes to ensure efficient and quality work.<sup>59</sup>

The City of San Diego maintains guidelines for billing by outside consultants and contractors. Specifically, City of San Diego Administrative Regulations state that all consulting agencies that contract with the City must:

[E]xpressly warrant that the work is based upon its expertise and shall be done in accordance with good (audit, professional, etc.) practices. Where approval by the City, or representatives of the City is indicated, it is understood to be conceptual approval only and does not relieve the consultant of responsibility for complying with all laws, codes and good (audit, professional, etc.) practices.<sup>60</sup>

The San Diego City Attorney's Office has established a set of internal controls to be used when reviewing attorney and consultant billings. The City Attorney uses specific billing guidelines that require detailed billing. The guidelines require that the invoice shall be accompanied by a separate invoice briefly describing each task performed, the time spent on the task, the identity of the person who performed the work, and itemized reimbursable expenses.<sup>61</sup>

Kroll and Willkie Farr have sent more than 10 invoices to the City of San Diego without providing sufficient detail of the work performed. The lack of accurate billing has rendered the City unable to properly monitor the engagements.

Kroll sent eight invoices to the City between the time it was hired on 14 February 2005 and the first update to the City Council on 14 June 2005.

---

<sup>59</sup> American Institute of Certified Public Accountants' handbook titled "Codification of Statements on Auditing Standards. Section: "AU § 319 – Consideration of Internal Control in a Financial Statement Audit." (Exhibit 42)

<sup>60</sup> City of San Diego Administrative Regulation. Appendix B-1. A Consultant is an Independent Contractor. (Exhibit 43)

<sup>61</sup> San Diego City Attorney's Office Billing Guidelines for Outside Counsel. (Exhibit 44)

The total charge for those eight invoices was \$1,207,549.<sup>62</sup> The bills were broken down among three classifications: “Internal Investigations,” “Research Pension Board Nominees,” and “For Professional Services Rendered.”<sup>63</sup> The bills include the names of more than 20 individuals, each billing for a specific numbers of hours at rates ranging from \$85 to \$950 per hour. The bills do not include any information about what tasks each individual performed.

Willkie Farr submitted its first bill to the City on 17 May 2005, for a sum of \$25,406.<sup>64</sup> The bill included a breakdown of services, in half-hour increments and the initials of the employee working on the task. The descriptions on the billing included items such as “review reports and correspondence” and “Begin reading Luce, Forward report.” The invoices complied with the City’s billing requirements for describing attorney’s work. That bill would be the last detailed invoice submitted by the firm to the City.

Kroll senior officials sent a status report to the City Council on 10 June 2005. The report stated that Kroll employees had been working with Vinson & Elkins employees to gather information, coordinate with KPMG, communicate with law enforcement agencies, collect additional documents, and prepare correspondence with the SDCERS Board.

Representatives of Kroll and Willkie Farr appeared before the televised City Council meeting on 14 June 2005 to give a presentation on their progress and answer questions from City officials. At the meeting, Mr. Levitt told the City Council that Kroll’s work – which includes comparing the City Attorney and Vinson & Elkins investigations, writing and issuing an investigative report, and drafting remediation steps – would be completed

---

<sup>62</sup> Source: Kroll Invoices from 30 March 2005, 5 April 2005, 5 April 2005, 18 April 2005, 27 April 2005, 9 May 2005, 20 May 2005, 3 June 2005. (Exhibit 45)

<sup>63</sup> Source: Kroll Invoices from 30 March 2005, 5 April 2005, 5 April 2005, 18 April 2005, 27 April 2005, 9 May 2005, 20 May 2005, 3 June 2005. (Exhibit 45)

<sup>64</sup> 17 May 2005. Willkie Farr & Gallagher bill to City of San Diego. (Exhibit 46)



before the end of the calendar year. Levitt said, “I would be very disappointed if I wasn’t out of here by the end of the year.”<sup>65</sup>

At this point, Kroll had not provided any detailed billing or a written work plan. The lack of details in the Kroll invoices left the City unable to discern what, if any, work was being done. Neither Kroll nor Willkie Farr provided the City Council or the City Attorney with a work plan or schedule.

City Attorney asked Mr. Levitt at the 14 June 2005 televised City Council meeting if such a work plan could be drafted and delivered. Levitt said, “I see no reason why we can’t give you a written report on our action.”<sup>66</sup> To date, the City Attorney cannot confirm that an appropriate written work plan has been provided to the City. The City Attorney also requested that Kroll provide detailed billings of its work. That request was neither responded to nor observed in practice. The City Attorney has also referred the issue to the San Diego County Grand Jury.<sup>67</sup>

On 22 June 2005, Willkie Farr submitted another bill to the City for \$232,725.<sup>68</sup> This bill, unlike the first bill from the Willkie Farr firm, included no details on the work being performed. The City failed to adhere to internal control standards when it did not require Willkie Farr to prepare the detailed billings.

One week later, on 24 June 2004, another bill from Kroll for \$194,194 was received by the City. The billing was broken into two classifications: “For Professional Services Rendered” and “Out-of-Pocket Disbursements.”

---

<sup>65</sup> Transcript of Arthur Levitt’s comments at the 14 June 2005 meeting of the San Diego City Council. (Exhibit 47)

<sup>66</sup> Transcript of Arthur Levitt’s comments at the 14 June 2005 meeting of the San Diego City Council. (Exhibit 48)

<sup>67</sup> 10 April 2006. Letter from San Diego City Attorney Michael J. Aguirre to the San Diego County Grand Jury. Re: San Diego City Attorney Requests Grand Jury to Expand Investigation of City of San Diego’s Use of Enterprise Funds to Pay for General Fund Costs. (Exhibit 106)

<sup>68</sup> 22 June 2005 Willkie Farr & Gallagher bill to City of San Diego. (Exhibit 49)

The billing included a list of 12 employees, their hourly rates and charges, but lacked any information about the work being performed.<sup>69</sup>

At the 28 June 2005 meeting of the City Council, an item was docketed to allocate an additional \$708,825 to Kroll to proceed with their work on the investigation and perform background research on appointees to the SDCERS Board. The Council passed the item 8 to 0, with Council member Ralph Inzunza absent.<sup>70</sup> The next day, 29 June 2005, Kroll sent a bill to the City Council for \$236,281.<sup>71</sup> The invoice was broken into "For Professional Services" and "Out-of-Pocket Disbursement." Again, the bill included only names, hourly rates, and the total billed.

Kroll again appeared before the City Council on 9 August 2005, to provide another status report and to receive allocation of additional funds. Outlining work completed to date, Levitt said:

First, we have engaged in extensive dialogue with the City's investigators at Vinson & Elkins and evaluated the extent of additional work necessary, so that the investigation may be brought to a conclusion. Second, we have met with the City's outside auditors at KPMG, discussed with them at great length the investigative material and are in the process of implementing an agreed upon plan which at its conclusion would allow KPMG to issue an audit report on the City's financial statements. Third, we have begun to work on remediation efforts including the removal of the retirement system's actuary and working with a new City Auditor and controller who are appropriately improving internal controls. Fourth, we have organized and are overseeing the production of documents that both the SEC and the U.S. Attorney subpoenaed more than a year ago. Fifth, over the course of our work these last five months we've had several discussions and meetings

---

<sup>69</sup> 24 June 2005 Kroll invoice to P. Lamont Ewell. (Exhibit 50)

<sup>70</sup> 28 June 2005 meeting of the San Diego City Council. (Exhibit 51)

<sup>71</sup> 29 June 2005 Kroll invoice to P. Lamont Ewell. (Exhibit 52)

with the independent auditors [KPMG] who support our approach and our efforts.<sup>72</sup>

Levitt also stressed that the expected completion date for Kroll's work was December 2005.<sup>73</sup> At that meeting the Council approved the allocation of \$1.2 million for the Kroll investigation on a 6 to 0 vote.<sup>74</sup> At the meeting, the City Attorney displayed the Kroll billings and stated that without any line item detail, the City was unable to document what work had actually been completed.

That same day, 9 August 2005, the City Attorney wrote a memo to San Diego City Auditor John Torell seeking support to require detailed bills. The City Attorney wrote, "It is impossible for the Auditor to verify these amounts are justified without sufficient documentation. In order to protect taxpayers' monies, we request that the Auditor demand and review more detailed documentation before paying any further invoices."<sup>75</sup>

In 2005, the County Grand Jury launched an investigation into the City of San Diego's alleged utilization of enterprise fund monies for general fund expenses. As a result, the County Auditor is currently performing an audit of City of San Diego financial records to determine if, in fact, money was illegally diverted from San Diego's Water and Wastewater enterprise funds to pay for general fund services.

The City Attorney believes these money diversion schemes have occurred and as a result of past management deficiencies may still be occurring due to a lack of management oversight.

---

<sup>72</sup> Transcript of Arthur Levitt's comments at the 9 August 2005 meeting of the San Diego City Council. (Exhibit 53)

<sup>73</sup> Transcript of Arthur Levitt's comments at the 9 August 2005 meeting of the San Diego City Council. (Exhibit 53)

<sup>74</sup> Minutes for the San Diego City Council meeting on 9 August 2005. (Exhibit 54)

<sup>75</sup> 9 August 2005 memorandum from City Attorney Michael Aguirre to City Auditor John Torell. Carbon-copied to P. Lamont Ewell. Subject: Insufficiency of Documentation for Payments to Kroll and Willkie, Farr. (Exhibit 55)

On 11 August 2005 the City Attorney wrote another letter to Kroll officials requesting more detailed billings. The City Attorney wrote, "The City Attorney again requests that Kroll and its legal counsel provide detailed billings for all amounts thus far billed to or paid by the City of San Diego. Although such billings are required under applicable City contract provisions and policies, they have not been provided."<sup>76</sup>

The City Attorney issued another letter to Troy Dahlberg on 6 September 2005 requesting more detailed billings.<sup>77</sup> Officials at Kroll or Willkie Farr have not responded to either letter.

Kroll later sent a bill to the City on 23 September 2005, for a total of \$231,912. Despite the repeated requests from the City Attorney, the sole detail listed by Kroll for the work was "For Professional Services Rendered."<sup>78</sup>

Representatives of Kroll and Willkie Farr appeared before the televised City Council meeting on 26 September 2005 to provide an update on its progress. At the meeting, Benito Romano and Troy Dahlberg both said that detailed billings were not provided to the City because City Manager P. Lamont Ewell said it was not necessary. Dahlberg and Ewell both stressed that the City maintained the right to audit the work of Kroll and Willkie Farr at any time. During this conversation, the City Attorney said the City Manager does not hold the authority to relieve a consultant of the requirement to comply with the City's billing guidelines or AICIPA requirements set forth in AU § 319.<sup>79</sup>

At the meeting, the City Attorney asked Troy Dahlberg why detailed billings were not being provided. Dahlberg replied that the information was not included for three reasons. First, accountants don't bill "that way."

---

<sup>76</sup> 11 August 2005. Letter from City Attorney Michael Aguirre to Arthur Levitt, Troy Dahlberg, and Lynn Turner. (Exhibit 56)

<sup>77</sup> 6 September 2005 letter from City Attorney Michael Aguirre to Troy Dahlberg. (Exhibit 57)

<sup>78</sup> 23 September 2005 Kroll invoices to P. Lamont Ewell. (Exhibit 58)

<sup>79</sup> Transcript of the 26 September 2005 meeting of the San Diego City Council. (Exhibit 59)

Furthermore, Dahlberg stated that Kroll does not have the technology to compile the bills on a half-hourly basis. Dahlberg also said that the bills are vague to protect those being investigated. Dahlberg said:

We are basically accounting. I am an accountant, okay. We don't even have a system that does this. Attorneys bill that way. Accountants tend to bill more on tasks... We don't really have the billing records to set this up. It would be a titanic economic expense for us to do it... I've done lots of investigations before and we do not show in the investigation in the bills that we are doing the investigative work on because, unfortunately, there is sometimes a presumed level of guilt if you just look at somebody's stuff... When we did these kinds of investigations we never went into the kind of detail about whose e-mail we were looking at, whose documents we were looking at.<sup>80</sup>

Mr. Dahlberg is both a certified public accountant and a lawyer. Another letter was sent by the City Attorney to Deputy Mayor Toni Atkins and City Council members on 24 October 2005, repeating the need for detailed billings to ensure that work is progressing. The letter states:

The City Attorney's Office has repeatedly requested all invoices for Kroll and Willkie Farr & Gallagher. Those requests have been met with resistance. The public's funds and confidence in government are seriously compromised by the practice of bypassing the City Attorney's Office to review these expenses. The Invoices submitted by Kroll for their work are wholly inadequate and contrary to best, let alone acceptable billing practices.<sup>81</sup>

Also on 24 October 2005, another Kroll bill was received by the City for a total of \$465,862.<sup>82</sup> Despite the numerous request from the City Attorney for a line item accounting of what work was being done, the time

---

<sup>80</sup> Transcript of the 26 September 2005 meeting of the San Diego City Council. (Exhibit 59)

<sup>81</sup> 24 October 2005. Letter from City Attorney Michael Aguirre to Deputy Mayor Atkins and City Council. (Exhibit 60)

<sup>82</sup> 24 October 2005 Kroll invoice to P. Lamont Ewell. (Exhibit 61)

spent on each task, and which employee was completing the work, the bill arrived with no detail other than cost. More than \$1.5 million of Kroll's bills were accepted and paid by the City without itemization.

The first Kroll bill sent to the City included only a line item of tasks being worked and the costs of that work was delivered on 16 November 2005 for a total of \$685,408.<sup>83</sup> The City Attorney believes that these invoices are insufficient to meet the internal controls of the City because the individual employees' tasks and the number of hours spent on each task are not provided.

Under Kroll's new billing practices, the City remains unable to perform an accurate audit to ensure that the tasks listed are in fact being completed. Kroll submitted a series of 10 bills from 18 November 2005 through 16 March 2006 for a total of \$2,460,361<sup>84</sup>. None of the billings included a detailed account of what task was being performed, by whom, or the time spent.

Willkie Farr also began submitting bills that included employee names, hours billed and their total costs. In a separate graphical matrix, the tasks that were being completed and the total costs of the tasks were listed. The firm submitted seven bills from 15 July 2005 through 30 January 2006 totaling \$3,550,446.<sup>85</sup>

Over the course of the engagement, the City failed to require detailed billings from Kroll and kept no control over the nature, timing, quantity, or quality of the work completed.

---

<sup>83</sup> 16 November 2005 Kroll invoice to P. Lamont Ewell. (Exhibit 62)

<sup>84</sup> Kroll invoices to City of San Diego for 18 November 2005; 10 January 2006; 19 January 2006; 23 January 2006; 30 January 2006; 3 February 2006; 9 February 2006; 21 February 2006; 8 March 2006; and 16 March 2006. (Exhibit 63)

<sup>85</sup> Willkie Farr & Gallagher invoices to City of San Diego for 15 July 2005; 31 August 2005; 19 September 2005; 19 October 2005; 16 November 2005; 30 January 2006; and 7 March 2006. (Exhibit 64)

## VI.

### KROLL COMPROMISED ITS INDEPENDENCE

The most important -- and most frequently cited -- reason to hire Kroll Inc. and Willkie Farr & Gallagher was their independence. It was believed that the firms, having no ties to the City, would be able to conduct a thorough, proper investigation as provided by AU § 317.<sup>86</sup> The investigation was requested by KPMG and was deemed necessary to complete the City's 2003 CAFR. Kroll was specifically hired by the City in February 2005 to conduct an "independent assessment" of a series of separate reports produced by the City Attorney and Vinson & Elkins.<sup>87</sup>

However, the relationship between Kroll and Vinson & Elkins was not independent. The City Attorney believes that Kroll appears to have overstepped the scope of the contracted work and this is particularly true with Kroll's oversight over the production of Vinson & Elkins' second report. Moreover, this has compromised the validity of any report ultimately released by Kroll.

The relationship between Kroll and former City Manager Lamont Ewell, Council members Scott Peters, Toni Atkins, and Jim Madaffer also raises questions about the firm's ability to conduct a fair, thorough, and honest investigation into illegal acts and alleged violations of law by City Officials. A series of e-mails recovered from the hard drive of Ewell illustrate that Kroll was engaged in activities expanding far beyond their contractual obligation.

As stated earlier in this report, Vinson & Elkins was directed to conduct a second, more detailed investigation after KPMG found the 16 September 2004 report to be insufficient. In July 2005, Vinson & Elkins issued a draft second report, submitted it to the representatives of Kroll<sup>88</sup>,

---

<sup>86</sup> American Institute of Certified Public Accountants AU § 317 – Illegal Acts by Clients (Exhibit 6)

<sup>87</sup> 10 February 2005 letter from Troy Dahlberg to Mayor Richard Murphy. Re: Independent Services for the City of San Diego. (Exhibit 14)

<sup>88</sup> 15 July 2005. E-mail from Jennifer Arnini to Michael Young, Benito Romano, and Brian Turetsky. (Exhibit 65)

but did not release on the record to City Council or the City Attorney. Rather, in response to a series of questions by the City Attorney and Council member Donna Frye in August 2005, Troy Dahlberg admitted the existence of a draft copy and reluctantly turned it over to City officials.<sup>89</sup>

The report found that the City did not adhere to proper accounting and financial disclosure practices on its CAFR. However, it concluded that no individuals knowingly violated any laws.<sup>90</sup> The report was discounted by KPMG and was widely considered to be another Vinson & Elkins “white wash”.

According to submitted invoices to the City by Vinson & Elkins, members of the Kroll team worked closely with representatives of Vinson & Elkins in organizing documents and drafting the second Vinson & Elkins report. Further evidence of the lack of independence between Kroll, V&E, and City officials – including City Council members – was found in Ewell’s e-mail box.

#### **A. KROLL AND VINSON & ELKINS**

A key element of the work to be performed by Kroll consisted of reconciling the reports of the City Attorney and Vinson & Elkins. This would necessarily mean that Kroll would and should be scrupulous in maintaining its independence from Vinson & Elkins. However, Kroll’s independence from Vinson & Elkins was compromised as early as April of 2005, according to invoices submitted by Vinson & Elkins, members of the Kroll team began working directly with Vinson & Elkins on preparing and drafting the Vinson & Elkins’ second report.

In late May, Richard Sauer, a partner at Vinson & Elkins, spent 10 hours working on a “Draft report regarding securities law violations.” During this time – between 24 May 2005 and 31 May 2005 – Paul Maco spent more than 30 hours meeting with Kroll representatives. Sauer then met with the Kroll team on 27 May 2005 for 5.50 hours for “team conferences” and “draft memo.” Maco then met with the Kroll team on 31 May 2005 for

---

<sup>89</sup> 1 August 2005 meeting minutes of the San Diego City Council.

<sup>90</sup> Vinson & Elkins draft report titled “Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals. 15 July 2005. (Exhibit 25)



2.5 hours to “continue report preparation.”<sup>91</sup> The second report from Vinson & Elkins would not be released until August.

It is difficult to see how Kroll could maintain its objectivity and independence in the task for which it was retained by the City – the review, evaluation and comparison of the Vinson & Elkins and City Attorney reports – when Kroll was working directly with Vinson & Elkins in creating the firm’s follow-up report.

On 16 February 2005, Lynn Turner sent an e-mail to Ewell explaining that V&E would, in effect, report directly to Kroll. Turner wrote, “Lamont – just to let you know I had a good call with Paul Maco yesterday and was able to communicate with Les Hand who was in NYC. Paul and I set up a reporting arrangement whereby he will report to us...”<sup>92</sup>

The message was sent just days after the City Council approved the letter of engagement with Kroll in February and months before V&E released its second report. The message clearly illustrated that V&E and Kroll were working closely since the beginning of Kroll’s work for the City.

The second report clearly failed to meet the requirements of AU § 317, which was explicitly required by KPMG in its earlier letters to the City. Neither of the investigative reports by Vinson & Elkins included an analysis of the computer hard drives of City Council members and their staffs, according to Paul Maco at the 9 August 2005 meeting of the City Council.<sup>93</sup>

The second report also failed to properly track down information following the questioning of witnesses. Specifically, the report discussed the Mayor’s Blue Ribbon Committee on Finances report. Vinson & Elkins describes the report as, “The first significant warning as to the possible long-term consequences of the City’s attempts to minimize its contributions and reported liabilities to SDCERS came from a committee appointed by Mayor

---

<sup>91</sup> 7 June 2005. Vinson & Elkins invoices to P. Lamont Ewell. (Exhibit 76)

<sup>92</sup> 16 February 2005. E-mail from Lynn Turner to P. Lamont Ewell. Subject: SAn Diego. (Exhibit 77)

<sup>93</sup> Transcript of the 9 August 2005 meeting minutes of the San Diego City Council. (Exhibit 79)

Murphy to assess the City's long-term financial health.”<sup>94</sup> The Blue Ribbon Committee report was presented to the City Council's Government Rules and Finance Committee on 27 February 2002.<sup>95</sup>

San Diego businessman Richard Vortmann was responsible for studying and writing the section of the Blue Ribbon Committee report focusing on the Pension system. Overseeing the work of Vortmann on the report were former City Auditor Ed Ryan and former Acting City Auditor Terri Webster. The second Vinson & Elkins report contains correspondence between Webster and Ryan illustrating repeated attempts to soften Vortmann's downcast financial assessment.

Vinson & Elkins and Kroll, however, did not adequately investigate the extent of the communications, whether other City officials directed Ryan and Webster, or examine the potential legal implications.

In the report, Vortmann correctly identified potential problems in the system including a growing liability for retiree medical care and the artificial health of the pension funded liability. Vortmann's report stated that, at the time, the funded ratio of SDCERS was 97 percent.

That information was inaccurate at the time of the presentation because the newest valuation for the SDCERS had been released to the Board on 12 February 2002 which pegged the unfunded liability at 89 percent. The 97 percent funded number represented financial information as of June 2000 while the 89 percent number reflected the newer figures as of June 2001.

Vortmann was a member of the SDCERS Board in the months immediately preceding the presentation of the Blue Ribbon Committee Report and was privy to the new valuation, but made no effort to include information before the hard copy of the report had been finalized and approved by the Committee. Vinson & Elkins interviewed Vortmann and Terri Webster, former acting auditor for the City of San Diego, who oversaw the production of the report, about the failure to include the new numbers.

---

<sup>94</sup> Vinson & Elkins draft report titled “Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals. 15 July 2005. P. 45-50. (Exhibit 80)

<sup>95</sup> 27 February 2002. Blue Ribbon Committee Report on City of San Diego Finances. (Exhibit 81)

In an interview with VINSON & ELKINS, Mr. Vortmann stated that he could not recall whether he received and read the FY 2001 actuarial report prior to the publication date of the Blue Ribbon Committee Report but, in any event, found that it simply confirmed his view that FY 2001 would bring further decline in funded level. Thus, in Mr. Vortmann's view, it did not materially affect the overall presentation of the report. Ms. Webster told V&E that she remembered some discussion among members of the Blue Ribbon Committee about including the updated number, but believes this was not done because, among other things, the actuary's report had not yet been accepted by the SDCER Board."<sup>96</sup>

The Vinson & Elkins report, however, also included a letter that Vortmann had written on 18 February 2002 to Frederick Pierce IV, then president of the SDCERS Board, where the new actuarial valuation was discussed. Therefore, this information had been released, was discussed by Vortmann in a letter to Pierce, but was not included in the report. Vinson & Elkins and Kroll, who oversaw the writing, failed to adequately investigate why the information was not presented to the City Council Committee.<sup>97</sup>

The City Attorney believes that the newest information showing the deteriorating financial health of the pension's funded ratio should have been included in the report as stated in the City Attorney's Second Interim Report.

The second report by Vinson & Elkins which Kroll oversaw also overlooked one of the most important pieces of evidence discovered in the course of the investigations: an e-mail exchange between Ed Ryan, Terri Webster, and two of the City's labor negotiators, Dan Kelly and Mike McGhee.

The topic of the correspondence is the "presidential benefit" that Ron Saathoff would receive as part of the Manager's Proposal II deal. Saathoff, at the time, was president of the San Diego Firefighters Union Local 145 and

---

<sup>96</sup> Vinson & Elkins draft report titled "Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals. 15 July 2005. P. 44-50. (Exhibit 80)

<sup>97</sup> Vinson & Elkins draft report titled "Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals. 15 July 2005. P. 44-50. (Exhibit 80)

also a member of the SDCERS Board. In short, the e-mail illustrates that Saathoff, the City, and the retirement board members were all aware that the boosting of retirement benefits was contingent upon the SDCERS Board allowing the City to underfund the pension. McGhee wrote to Ryan, Webster, and Kelley, "I assure you that Ron is well aware of the contingent nature of the benefits."<sup>98</sup> The City Attorney discussed the e-mail extensively in the Second Interim Report which was released on 9 February 2005.

This information, however, was not discussed in the second Vinson & Elkins report, the very report that Kroll oversaw. In fact, the report stated that no evidence existed to establish a quid pro quo or contingent arrangement in the passage of Manager's Proposal II. Vinson & Elkins wrote, "A link between MP2 and the Union Presidents' Resolution is not clearly established by the evidence available to us at this time. The San Diego District Attorney has charged Mr. Saathoff (and others) with a conflict of interest in voting in favor of MP2, in part due to an alleged link between that measure and the union presidents' benefit."<sup>99</sup>

The complete failure to include this valuable piece of evidence in the assessment of illegal acts analysis, again, illustrates that Kroll's credibility to continue an investigation into the City has been irreparably compromised.

## **B. KROLL AND CITY OFFICIALS**

Even before Kroll was hired by the City to "receive, review and evaluate the findings of the investigations by V&E and the City Attorney,"<sup>100</sup> Kroll officials were intimately involved in City business. City Manager Ewell sent an e-mail to Turner and Dahlberg on 2 February 2005 seeking information about the hiring of a new City Auditor.

---

<sup>98</sup> 21 May 2002 E-mail from Labor Relations officer Mike McGhee to Ed Ryan, city auditor; Terri Webster, assistant city auditor; and Dan Kelley, labor relations manager. (exhibit 82)

<sup>99</sup> Vinson & Elkins draft report titled "Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals. 15 July 2005. P 60-63. (Exhibit 83)

<sup>100</sup> 10 February 2005. Letter from Troy Dahlberg to Mayor Richard Murphy and San Diego City Council. Re: Independent Services for the City of San Diego. (Exhibit 14)

Ewell was in the process of interviewing John Torell and asked Turner and Dahlberg, "Should you have any knowledge of this person or reason to believe the City should not pursue hiring him, I would personally like to know. I will be negotiating employment terms with him this weekend. Sorry I failed to mention this during our conversation."<sup>101</sup> This was the first of many decisions in which Kroll would exceed the firm's engagement with the City and compromise its independence from City officials.

More disturbing, Turner wrote an e-mail to Ewell on 17 February 2005 stating that "The SEC staff called this morning and asked if I would talk to them this afternoon. One thing I intend on doing during the telephone call with the SEC staff is to establish a good relationship and protocol with them."<sup>102</sup>

Turner went on to state that, "I will be telling them we should be viewed very much as an independent audit committee in this situation."<sup>103</sup> Kroll exceeded its authority by dealing directly with the SEC. Not only did this exceed Kroll's contractual mandate, but Kroll proceeded with the full the full knowledge of the city manager who offered no objection. Kroll was without the authority to communicate with the SEC on the City's behalf.

Nonetheless, a representative of the SEC Pacific Regional office, followed the telephone conversation up with a letter to Turner on 23 February 2005 requesting a meeting to "better understand the processes you will undertake and the timeline for the completion of your work." It also specifically recommended "that you include the Mayor, a representative of the City Council, the City Manager, City Attorney, and representatives of Vinson & Elkins and KPMG in the meeting to facilitate our complete understanding of the City's objectives and undertakings with respect to your

---

<sup>101</sup> 2 February 2005. E-mail from P. Lamont Ewell to Lynn Turner and Troy Dahlberg. Subject: "appointment of new Auditor." (Exhibit 66)

<sup>102</sup> 17 February 2005. E-mail from Lynn Turner to Leslie Girard and P. Lamont Ewell. Subject: "SEC Call." (Exhibit 67)

<sup>103</sup> 17 February 2005. E-mail from Lynn Turner to Leslie Girard and P. Lamont Ewell. Subject: "SEC Call." (Exhibit 67)

retention.”<sup>104</sup> Turner forwarded a proposed meeting time to Ewell and Dahlberg on 23 February 2005.

Kroll’s burgeoning working relationship with City Manager Ewell reveals that Kroll was failing to remain independent of the City Manager and was also moving closer to inappropriate entanglements with other City officials. On 24 February 2005, Turner e-mailed Ewell to discuss the City Council members – Scott Peters and Toni Akins – who Kroll has selected to attend a meeting with the SEC.<sup>105</sup>

Turner and Ewell made the arrangements between themselves and the SEC; neither the public nor the City Attorney’s Office was involved. Kroll was becoming increasingly involved in decision making for which they had no mandate and that was not part of their contracted relationship with the City. Moreover, Kroll was inviting individuals into their ad hoc decision-making group who were, in part, the focus of the investigation. Not only was Kroll exceeding its authority but it was doing so in a way that indicates Kroll had no intention of drawing boundaries necessary to maintain independence.

The relationship between Turner and Ewell goes further. In a 23 April 2005 e-mail, Turner suggested that he could handle a phone call from one of the credit ratings agencies. Turner wrote to Ewell, “I know some of the people at Moody’s in the corporate governance area very well including Ken Bertsch and Greg Jonas. I would be very happy to take a call from Moody’s.”<sup>106</sup> The ratings agency had dropped the City’s credit rating in September 2004 from “Aa3” to “A1.”<sup>107</sup>

---

<sup>104</sup> The City Attorney does not suggest this communication by the SEC was improper. (Exhibit 68)

<sup>105</sup> 24 February 2005. E-mail from P. Lamont Ewell to Lynn Turner. Subject: “Re: City Council Members” (Exhibit 70)

<sup>106</sup> 23 April 2005. E-mail from Lynn Turner to P. Lamont Ewell. Subject: “Re: Horribly Misquoted.” (Exhibit 71)

<sup>107</sup> Hall, Matthew. “Another credit rate downgrade announced.” *San Diego Union-Tribune*. 25 September 2004. (Exhibit 72)

Ewell replied that he would, “refer Moodies [sic] to you and will suggest that they call you as part of my presentation.”<sup>108</sup> The communication raises concerns that representatives of Kroll were using influence to lobby credit ratings agencies on behalf of the City of San Diego. This again raises significant concern over the company’s independence and ability to issue a truly “independent” investigative report.

Turner began including Council members Toni Atkins and Scott Peters on regular updates that were formerly the exclusive privilege of Ewell. Peters wrote an e-mail on 25 April 2005 to Ewell, Turner and Dahlberg stating, “I appreciated the call from Lynn recently explaining the next steps, and understand and support the retention of counsel [Willkie Farr & Gallagher]. I do feel a little out of the loop myself, however, especially on the schedule. I’d really appreciate a sense of where that is and what factor would affect it.”<sup>109</sup>

The communication indicates that certain Council members, who were the subject of an illegal acts investigation, received updates on the status of the investigation. Peters, in the e-mail, also blurs Kroll’s line of independence by offering assistance and writes, “I am willing to do whatever I can to encourage the retirement board to release as many of the desired documents as possible.”

These e-mails clearly indicate a relationship between representatives of Kroll and certain members of the City Council that compromise Kroll’s ability to conduct an independent “illegal acts” investigation of City officials. The City Attorney believes that Council members who were the target of Kroll’s probe should not have received updates on the direction and status of the investigation.

The City Attorney believes that Kroll’s independence has also been compromised by working in conjunction with the offices of the Mayor and City Manager throughout the investigation. Both the offices are primary focuses of the investigation and both have played key roles in the production and management of documents.

---

<sup>108</sup> 23 April 2005. E-mail from P. Lamont Ewell to Lynn Turner. Subject: “Re: Horribly Misquoted.” (Exhibit 73)

<sup>109</sup> 25 April 2005. E-mail from Scott Peters to P. Lamont Ewell and Troy Dahlberg. Subject: “Audit Committee Issues”. (Exhibit 74)

The City Manager's office should not have been in the chain of custody of the documentary evidence in Kroll and Willkie Farr's investigation because employees of the City Manager's office were involved in the Manager's Proposal II in 2002 and other alleged illegal acts. A letter from the City's Chief Information Officer, Rey Arellano, to Lynn Turner on 23 June 2005 provides additional evidence that the City Manager's office played a key role in the collection, storage and disclosure of evidence important to the investigation.<sup>110</sup>

City Manager Lamont Ewell left the City of San Diego on 28 November 2005<sup>111</sup> and a new government system was instituted on 2 January 2006. As a result, two letters from Kroll and Willkie Farr have been sent to Mayor Jerry Sanders and Council member Scott Peters. The City Attorney believes that Council member Peters should not be included as a point of contact for the "independent investigators" because he is a subject of the investigation. Kroll's independence has been compromised because Ewell and certain of the Council members were directly involved in the alleged "illegal acts." Kroll was supposed to be reconciling the City Attorney's report finding substantial evidence that some council members had knowingly or recklessly violated federal securities fraud laws.

### **C. KROLL AND THE UNION-TRIBUNE**

Kroll has also compromised its independence by stepping outside of its contractual obligations with the City by meeting on multiple occasions and engaging in lobbying activities with the editorial board of the San Diego Union-Tribune.<sup>112</sup> Coincidentally, the newspaper has issued a series of

---

<sup>110</sup> 23 June 2005 letter from Rey Arellano, chief information officer for the City of San Diego, to Lynn Turner. (Exhibit 23)

<sup>111</sup> Lewis, Scott. "Longest Resignation Ever." *Voice of San Diego*. 28 November 2005. (Exhibit 98)

<sup>112</sup> The City Attorney finds it necessary to note that the newspaper did not act improperly when seeking comments and updates from high ranking consultants working for the City. The City Attorney believes the inappropriate acts occurred by representatives of Kroll and Vinson & Elkins who were without authority to conduct meetings with the press and charge the City for the time of said meetings.



editorial articles stressing the importance of paying Kroll and Willkie Farr millions of dollars.

Early in Kroll's work for the City, Ewell sent an e-mail on 3 March 2005 to Turner asking, "How do you feel about arranging a meeting with you and the Editor of the [Union] Tribune for Monday since you are here? It may help with the next days editorial, which will surely follow given the request of Council to sign the agreement."<sup>113</sup> The agreement Ewell mentions is a letter that Turner asked City Council members to sign to "refrain from the personal criticism and accusation...whether it be in this Chamber, the press conferences...or elsewhere."<sup>114</sup>

This period was marked by a contentious atmosphere following the City Attorney's release of Interim Reports. The City Attorney believes this was an effort by Ewell to use Kroll to lobby the Union Tribune editorial board, a task that Kroll was not contractually authorized or permitted to engage in. An additional Ewell e-mail illustrates that Kroll for months lobbied the Union-Tribune editorial board and representatives of the San Diego Regional Chamber of Commerce, a local pro-business lobbying group.

More than one month later, Ewell received an e-mail from Turner outlining an update to Union Tribune editors stating,

"I did have a call today with Bill Osbourn updating him on our progress – I did tell him this was not going to be done quickly as he was asking for timing. I said we were committed to the thorough and comprehensive investigation that KPMG would require prior to signing off. Bill Kettle [Bob Kittle, director of the Union –Tribune editorial page] was on the other line and Bill was going to have him call me when I return from DC."<sup>115</sup>

---

<sup>113</sup> 3 March 2005. E-mail from P. Lamont Ewell to Lynn Turner. Subject: "Re: Resolution/Letter for Council" (Exhibit 84)

<sup>114</sup> 7 March 2005. San Diego City Council resolution R-300203 (Exhibit 17)

<sup>115</sup> 12 April 2005. E-mail from Lynn Turner to P. Lamont Ewell. Subject: "Re: Update" (Exhibit 85)

Ewell continued to receive updates from Turner after conversations with the Union-Tribune editorial board. Turner sent an e-mail on 22 April 2005 stating, “Just got off the line with Kittle he seemed to understand what was going.”<sup>116</sup> As evidenced by Ewell’s e-mails Turner was also updating other members of the community. In a 24 April 2005 e-mail to Ewell, Turner wrote, “In addition to talking to the press, I have also alerted the Chamber as to current events as well as the two council members who are our contacts.”<sup>117</sup>

At this time, a series of articles touting the City’s need for Kroll appeared in the Union-Tribune editorial pages. The first article was a question and answer session between representatives of Kroll, Willkie Farr, and the Union-Tribune editorial board. According to the article, printed on May 15, 2005<sup>118</sup>, Levitt said about the timing of the investigation:

I think this project calls for a resolution by the end of the year. I don’t know very much about whether it’s a million or two million or exactly what the number is.<sup>119</sup>

Turner, who was also present at the meeting, echoed Levitt’s timing estimates. Turner said, “We’ve got to be there by the end of the year.”<sup>120</sup> The next Union-Tribune editorial appeared on 11 August 2005 and provided a more forceful endorsement for Kroll. The Union-Tribune editorial board wrote:

The indispensable key to getting the city back on its feet financially is the three-member audit committee chaired by

---

<sup>116</sup> 22 April 2005. E-mail from Lynn Turner to P. Lamont Ewell. Subject: “Re: Just got off the line with Kittle” (Exhibit 86)

<sup>117</sup> 24 April 2005. E-mail from Lynn Turner to P. Lamont Ewell. Subject: “Re: Horribly Misquoted.” (Exhibit 87)

<sup>118</sup> 15 May 2005. “Q&A: Lynn Turner, Arthur Levitt, Benito Romano.” *San Diego Union-Tribune*. (Exhibit 88)

<sup>119</sup> 15 May 2005. “Q&A: Lynn Turner, Arthur Levitt, Benito Romano.” *San Diego Union-Tribune*. (Exhibit 88)

<sup>120</sup> 15 May 2005. “Q&A: Lynn Turner, Arthur Levitt, Benito Romano.” *San Diego Union-Tribune*. (Exhibit 88)

former Securities and Exchange Commission chairman Arthur Levitt. Operating with total independence, the panel is assisting KPMG, the city's outside auditor, in completing the stalled financial statements that have locked San Diego out of capital markets for over a year... This probe is instrumental to both the SEC's anticipated enforcement action against the city and U.S. Attorney Carol Lam's criminal investigation... Without the independent oversight provided by the audit committee, all of San Diego's efforts to regain its financial strength would collapse in one catastrophic stroke... If Aguirre is incapable of becoming part of the solution, he at least must stop obstructing those who are committed to moving San Diego forward responsibly.<sup>121</sup>

The Union-Tribune editorial board wrote the editorial in August and to date the City has received no work product from Kroll. Arthur Levitt also submitted an op-ed piece for publication in the San Diego Union-Tribune which was printed on 11 August 2005.<sup>122</sup> It is unclear, in light of any details in the billings, if the City was billed for the placement of the op-ed that advocated the necessity of retaining Kroll.

Representatives of Kroll appeared before the televised City Council meeting on 1 November 2005. When questioned by City Council members, Troy Dahlberg admitted to meeting with the editors of the San Diego Union Tribune and billing the City for that time.<sup>123</sup> Representatives of Kroll have also billed the City for meeting with the San Diego Regional Chamber of Commerce and The Wall Street Journal.<sup>124</sup>

The Union-Tribune editorial board provided another glowing recommendation of Kroll just days after new Mayor Jerry Sanders' took

---

<sup>121</sup> 11 August 2005. "Aguirre's Gambit." *San Diego Union-Tribune*. (Exhibit 89)

<sup>122</sup> Levitt, Arthur. "Reviving San Diego: Looking at the numbers at City Hall." *San Diego Union-Tribune*. 11 August 2005 (Exhibit 90)

<sup>123</sup> Transcript of the 1 November 2005 meeting of the San Diego City Council. (Exhibit 91)

<sup>124</sup> Christensen, Kevin. "City's audit Mired in billing controversy." *The Daily Transcript*. 1 November 2005. (Exhibit 92)

office. The editorial, released on 13 December 2005, challenged the Mayor to pay Kroll additional monies and, again, touted Kroll leaders' job qualification. The Union-Tribune editorial board wrote:

The keystone of San Diego's financial recovery is its independent audit committee. The city's ability to borrow money, issue certified financial statements and conduct a range of other essential business – not to mention get out from under the cloud of multiple federal probes – all hinges on the completion of the audit committee's investigation... Yet, astonishingly, the panel is on the brink of shutting down because of an interruption in its funding from the city.<sup>125</sup>

The editorial acknowledges Mayor Jerry Sanders was apprehensive about paying the company another \$14 million without a guarantee that the work would be completed or that a timeline for completion be provided. The Union-Tribune editorial board took aim and fired at Sanders' request in the editorial:

Mayor Jerry Sanders and the City Council must move quickly to avert this looming calamity.... The urgent solution here is for Mayor Sanders to reach an ironclad funding agreement with the audit committee that is satisfactory to KPMG in terms of the scope and duration of the investigation. Then Sanders must present the matter to the City Council as soon as possible... San Diego's fiscal upheaval demands strong, determined direction from the top. This all-important issue poses the first critical test of Jerry Sanders' leadership.<sup>126</sup>

While the City Council agreed on 17 January 2006 to provide Kroll with an additional \$10 million of funding, Kroll would not agree to any commitment to complete its investigations.

Rather, the e-mails, testimony and articles provide evidence that representatives of Kroll engaged in lobbying activities to apply political

---

<sup>125</sup> 13 December 2005. "Sanders' first test: Audit committee's probe must continue." *San Diego Union-Tribune* (Exhibit 93)

<sup>126</sup> 13 December 2005. "Sanders' first test: Audit committee's probe must continue." *San Diego Union-Tribune* (Exhibit 93)

pressure on City Hall to continue to pay bills without providing any evidence that work was being completed. The City Attorney believes that engaging in such activities compromises Kroll's ability to perform an independent investigation for the City.

#### **D. KROLL AND KPMG**

Kroll compromised its independence in its investigation into illegal acts in the City by defending KPMG which is concurrently working on the audit of the City's 2003 CAFR. On Monday, 29 August 2005, KPMG reached a preliminary agreement to pay \$456 million to settle charges brought by the federal government alleging the company created a tax shelter scheme defrauding more than \$1 billion from United States taxpayers.

The settlement, commonly referred to as a "consent decree," essentially admitted that the company was in violation of federal law and allowed the company to avoid potentially crippling charges in court. Meanwhile, the federal government prosecuted nine executives, who were removed from the firm.

When news of the settlement reached the national and international media, concerns were raised by KPMG's clients about the independence and credibility of the firm's work, specifically its audits. The Wall Street Journal and other international media outlets -- such as the British Broadcasting Corporation -- all issued news reports on the event. William Morris, western region director for KPMG, noted the concerns that clients had as a result of the settlement in the 12 September 2005 meeting of the San Diego City Council.<sup>127</sup> Morris said, "We took the matter extremely serious. We recognized it had ramifications to our firm, both our people and our clients. It was a serious matter and that we wanted it to be resolved."<sup>128</sup> The City Attorney believes that representatives of Kroll Inc. further compromised its independence in the investigation of the City of San Diego by defending KPMG in media reports.

---

<sup>127</sup> Transcript of the 12 September 2005 meeting of the San Diego City Council. (Exhibit 94)

<sup>128</sup> Transcript of the 12 September 2005 meeting of the San Diego City Council. (Exhibit 94)

In order for the audit of the 2003 CAFR by KPMG and the investigation by Kroll to be credible, each must maintain its complete independence. That independence includes the two firms being independent from one another. By vouching for KPMG Levitt and Turner created the appearance that KPMG was indebted to them. In turn KPMG has insisted that the City continue paying Levitt and Turner as a condition for KPMG issuing its opinion on the City's 2003 financial statement. Levitt and Turner helped KPMG keep its clients and KPMG helped Levitt and Turner keep the City of San Diego as a client. The public perception is that one hand was washing the other.<sup>129</sup>

In the article, Levitt was identified as the heading the City of San Diego's audit committee. Levitt in that capacity, without prior approval from the City Council or City Attorney vouched for KPMG:

I think the audit clients will stand by them, because as they survey the field, the alternatives are certainly no better, and hopefully KPMG has moved strenuously to correct the problems of the past.<sup>130</sup>

Levitt was cited as the "former Securities and Exchange Commission Chairman...who leads a committee supervising KPMG's audit of the city of San Diego finances." Lynn Turner was also quoted in the story and cited as "another member of the San Diego audit committee." In the ensuing months, the leadership of KPMG consistently defended the independence of the Kroll firm and promoted their competence and importance in the completing of an investigation into the City of San Diego meeting the guidelines of the AU § 319.

KPMG issued a letter on 22 September 2005 specifically promoting the use of Kroll. DeVetter stated,

---

<sup>129</sup> Weil, Jonathan. "KPMG's Settlement Provides for New Start: Agreement With U.S. Prosecutors Avoids Criminal Indictment; Civil, Class-Action Suits Remain." *The Wall Street Journal*. 29 August 2005. (Exhibit 95)

<sup>130</sup> Weil, Jonathan. "KPMG's Settlement Provides for New Start: Agreement With U.S. Prosecutors Avoids Criminal Indictment; Civil, Class-Action Suits Remain." *The Wall Street Journal*. 29 August 2005. (Exhibit 95)

KPMG continues to believe that it is important to the completion of the independent investigation that Messrs. Turner, Levitt and Dahlberg continue to take any and all actions they deem necessary or appropriate to satisfy their obligations under the terms of their retention by the City of San Diego.<sup>131</sup>

That same day, 22 September 2005, the Union-Tribune issued its third editorial article supporting the retention of Kroll and Willkie Farr.

## **VII.**

### **KROLL EXCUSES FOR DELAY NOT VALID**

Along with working on investigations, Vinson & Elkins was also hired to represent the City before the SEC. Part of this responsibility included assisting in document production in response to SEC subpoenas.

In order to make the documents production more efficient, Vinson & Elkins had been using an electronic discovery system product from NTI Breakwater for placement in a database, or documents repository, maintained by Applied Discovery, a subsidiary of Lexis-Nexis.

The City e-mail system is run off of a program called GroupWise, made by the Novell Inc. The hardware is proprietary and cannot be viewed on some computer programs.

Vinson & Elkins employed the NTI Breakwater product to convert the GroupWise documents to a file that can be opened and viewed by other computer programs for KPMG and federal investigators.<sup>132</sup> The files converted by NTI Breakwater were then placed in an electronic depository, or database, operated by Applied Discovery. KPMG and federal investigators were then given access to the Applied Discovery database where the documents were stored. In this database, the documents could be opened and viewed.

---

<sup>131</sup> 22 September 2005. Letter from Steven G. DeVetter to Acting Mayor Toni Atkins. Re: City of San Diego Fiscal Year 2003 Financial Statements Audit – Status Update. (Exhibit 96)

<sup>132</sup> 22 November 2004. City of San Diego consulting engagement agreement with NTI Breakwater. (Exhibit 99)

As early as January 2005, officials at Applied Discovery, KPMG and Vinson & Elkins realized that some of the attachments to documents were not being converted and placed into the database. In other words, if an e-mail, or “parent,” had an attachment, or “child,” the parent would appear in the Applied Discover database but the child was missing. Kelli Clark, an account manager at Applied Discovery, spotted the issue and forwarded information in an e-mail:

I had our production team look into doc 206722 at KPMG’s request. When our team looked at the pre-converted document, the links to the attachments were ‘dead’. Hence, the attachments are not extracted and linked to the e-mail on the ORA. Additionally, when we look at doc #125481 (the number of the attachment that you provided today) there is no evidence that this document is an attachment to any other doc in the system.<sup>133</sup>

Investigators at the SEC had realized this to be an issue early on, according to an e-mail sent from Ben Lippard, an attorney at Vinson & Elkins to Paul Maco. Lippard wrote:

There was only one issue of any real importance on the call today – the SEC was concerned about the fact that from applied discovery database you can’t tell which file attachments belong to which emails. I have instructed Kelli to consult with Anton about a technical fix to this issue, which it seems likely they will insist on.<sup>134</sup>

This was a problem because the SEC and KPMG had both repeatedly asserted the need to see all documents requested to ensure that alleged improprieties that landed the city in its current financial difficulties would not happen again. If some of the e-mails and other electronic documents were not available, the investigation could not be adequately completed.

---

<sup>133</sup> 10 January 2005. E-mail from Kelli Clark to Ben Lippard. (Exhibit 100)

<sup>134</sup> 8 February 2005. E-mail from Ben Lippard to Paul Maco. Carbon-copied to Rick Sauer and William Lawler. Subject: Update on SEC call. (Exhibit 101)



The problem was solved by Applied Discovery and NTI Breakwater on 2 May 2005 and a solution was presented to KPMG and the SEC in May. Kelli Clark wrote, "Ok. FYI – I just got word from our tech department that the family groups work is complete now. Whenever you give the go ahead, we are ready to begin the transfer."<sup>135</sup>

City Manager Lamont Ewell released a memo on 8 September 2005 stating that Vinson & Elkins had failed to review more than 57,000 files of the 160,000 relevant documents.<sup>136</sup> Ewell wrote that technology had broken down and blamed Vinson & Elkins for overseeing the maintenance of the issue. Ewell wrote:

The failure to include these files on the database has delayed the City's production of documents to the SEC and the United States Attorney's office. In addition, this error has caused the City to incur significant costs in having the missing files restored, and costs associated with a complete review of emails required by the Audit Committee, in addition to the attorneys' fees and expenses associated with creating and reviewing the original database.

It is my belief that V&E [Vinson & Elkins] was responsible for providing instructions to and supervising the work of ADI as part of its investigation and report to the City on disclosure matters.<sup>137</sup>

The next day the Vice President of Applied Discovery issued a letter to Lamont Ewell on 9 September 2005 stating that the problems had been identified in January and corrected in June.<sup>138</sup> Nagel stated that the staff of Applied Discovery had notified the City that the problems were corrected

---

<sup>135</sup> 2 May 2005. E-mail from Kelli Clark to Ben Lippard. Subject: RE: Transfer of data to a new database for the SEC. (Exhibit 102)

<sup>136</sup> 8 September 2005 letter from City Manager P. Lamont Ewell to Paul Maco, partner for Vinson & Elkins. (Exhibit 103)

<sup>137</sup> 8 September 2005 letter from City Manager P. Lamont Ewell to Paul Maco, partner for Vinson & Elkins. (Exhibit 103)

<sup>138</sup> 9 September 2005. Letter from Scott Nagel, vice president of Applied Discovery, to P. Lamont Ewell. (Exhibit 104)

and that the City did not want the corrections implemented. Specifically, Nagel wrote that the City ordered the corrections not to be implemented. Nagel wrote:

Upon discovery of this issue in January, ADI offered to resolve the issue. At the time, ADI was told that the resolution it offered was unnecessary for purposes of the review work being performed. Later, in the April/May timeframe, ADI was asked to resolve part of the issue that had been created (i.e., repairing links between documents already in the database) for purposes of preparing a production database for the City. ADI did so, and also offered to resolve the remainder of the issues (i.e., ensuring that all family members of relevant documents were also included in the database) by re-running searches on the City's behalf. ADI was told not to re-run the searches.<sup>139</sup>

Just days later, an item appeared before the San Diego City Council to allocate \$727,500 to hire consulting firm Electronic Database Discovery to build a second database for the storage of electronic documents obtained by the Kroll and Willkie Farr in its work. In September 2005, representatives of Kroll notified the City Manager of difficulties converting documents from the GroupWise system to an electronic format compatible with programs used by federal investigators.

The City at this point, however, had been experiencing the same problem. Despite the fact that NTI Breakwater and Applied Discovery – both of whom billed the City – solved the problem, the City's troubles persisted.

Representatives of Kroll and Willkie Farr submitted a letter to the City Council on 25 October 2005 stating that the problems with converting the electronic files properly will cause a delay in the completion of the investigation. The date was pushed from end of calendar year 2005 to mid-March 2006.

---

<sup>139</sup> 9 September 2005. Letter from Scott Nagel, vice president of Applied Discovery, to P. Lamont Ewell. (Exhibit 104)

The City Council also allocated another \$272,300 to increase the size of the database from 160 gigabytes to 240 gigabytes – enough to store 12 million pages of documents.<sup>140</sup>

The City Attorney finds that problems with the conversion of the files from GroupWise should have been avoided. The City Attorney also finds that the hiring and continued funding for another electronic database company is a tactic to delay the completion of the investigation and an unnecessary drain on the City's coffers.

## **VIII.**

### **CONCLUSION**

Based upon the facts and circumstances set forth in this report it is the San Diego City Attorney's considered judgment that the City should forth with terminate Kroll and Willkie Farr and take all appropriate legal action to recover all damages proximately caused by Kroll and Willkie Farr's breach of duties owed to the City of San Diego.

By \_\_\_\_\_  
Michael J. Aguirre  
City Attorney

---

<sup>140</sup> Hall, Matthew T. "Investigators get e-mail database: City OKs money to expand system in pension probe." *San Diego Union-Tribune*. 21 December 2005. (Exhibit 105)

# Exhibit 34

## Kroll report, quarreling both have early start | Details of 8 a.m. meeting next week upset leaders

[R,E,S,C Edition]

The San Diego Union - Tribune - San Diego, Calif.

Author: Matthew T. Hall

Date: Aug 3, 2006

Section: LOCAL

Text Word Count: 656

---

### Document Text

---

Editions vary

A \$20.3 million report on who's to blame for San Diego's fiscal collapse doesn't arrive until next week, but city officials are already sparring over it.

City Attorney Michael Aguirre and Councilwoman Donna Frye criticized Mayor Jerry Sanders and Council President Scott Peters yesterday for how they've allowed consultants from Kroll Inc. to present the long-awaited report.

"It sounds like what they're going to do is get in one of those limousines, drive by, throw the report out and just head to the airport," Aguirre said.

By signing a letter from Kroll's attorney earlier this week, Sanders and Peters agreed to the consultants' request that their presentation begin at 8 a.m. Tuesday and that the discussion be limited to the contents of the report.

No copies of the 400-page document will be handed out until the Tuesday meeting, Peters said.

The presentation will start at an unprecedented time for a City Council meeting, two hours before a separate, regularly scheduled council meeting is set to begin.

Peters is empowered by his council colleagues to set meeting times and agendas. Sanders has taken the lead at City Hall on dealing with the consultants from Kroll, a New York-based risk- management firm, for months.

Kroll was hired 18 months ago to satisfy the concerns of the city's outside auditors, KPMG, that San Diego hadn't fully investigated wrongdoing by city officials related to a \$1.4 billion pension deficit and other fiscal woes.

The report is one of many pieces San Diego needs to resume borrowing money from the bond market at attractive rates for a range of delayed capital projects.

Peters defended yesterday his scheduling of Kroll's presentation and said he wants to focus on the firm's report, not its council- approved contract, which has been criticized by Aguirre and others since last year.

"I don't want to take up a lot of time talking about \$20.3 million. That's water under the bridge," Peters said. "We have to use this time for the benefit of the city to figure out what we've learned and how we move forward."

Peters said yesterday he believes the presentation and ensuing question-and-answer period will not take much longer than the two hours he has scheduled, but he said the meeting will last as long as there are questions.

Tuesday night, mayoral aide Fred Sainz said the meeting was scheduled to last two hours. "Ten million dollars an hour," mayoral aide Bill Harris said.

Frye complained yesterday that she learned about the 8 a.m. meeting from the media instead of directly from Sanders or Peters. She said it was "irresponsible" for the two to condone any limitations on Tuesday's meeting.

"It's quite unusual to have the recipients of ... taxpayer dollars dictate terms and conditions under which their report shall be released," she said.

Aguirre said it was illegal to limit the public debate at the meeting.

"In no way would it be appropriate for Kroll to unilaterally impose upon the council restrictions on what they're prepared to discuss and what they're prepared to answer," Aguirre said. "They're working for us."

For some time, Aguirre has threatened legal action against Kroll for the cost and delays associated with its report. The consultants, hired in February 2005 with Aguirre's blessing, have for months only talked to Aguirre at public meetings in discussions more fit for opposing lawyers inside a courtroom.

Peters said a decision by Sanders to have the report released to everyone simultaneously Tuesday morning would preclude council members from asking questions for hours on end at the meeting.

"I'm not sure how many questions we can put together," Peters said. "We won't even see the report until minutes beforehand."

Peters said he asked Kroll to come at 11 a.m., but the consultants wouldn't budge from their 8 a.m. request. Consultant Troy Dahlberg and attorney Benito Romano, who are both working on the report, did not return calls yesterday.

Credit: STAFF WRITER

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

---

**Abstract** (Document Summary)

---

City Attorney Michael Aguirre and Councilwoman Donna Frye criticized Mayor Jerry Sanders and Council President Scott Peters yesterday for how they've allowed consultants from Kroll Inc. to present the long-awaited report.

Peters defended yesterday his scheduling of Kroll's presentation and said he wants to focus on the firm's report, not its council-approved contract, which has been criticized by Aguirre and others since last year.

For some time, Aguirre has threatened legal action against Kroll for the cost and delays associated with its report. The consultants, hired in February 2005 with Aguirre's blessing, have for months only talked to Aguirre at public meetings in discussions more fit for opposing lawyers inside a courtroom.

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

# Exhibit 35

**THIS EXHIBIT INTENTIONALLY  
LEFT BLANK**



# Exhibit 36

## Pension board rejects Aguirre's questions

[R,E,S,C Edition]

The San Diego Union - Tribune - San Diego, Calif.

Author: Jennifer Vigil

Date: May 20, 2006

Start Page: B.1.R.E

Section: LOCAL

Text Word Count: 840

---

### Document Text

---

City Attorney Michael Aguirre clashed yesterday with members of San Diego's pension board, when the panel's president stopped him from questioning an expert who studied the retirement fund's obligations and investment performance.

Board President Peter Preovolos refused to allow the city attorney to seek answers from the expert, actuary Gene Kalwarski, about his experience with pension funds as large as the San Diego City Employees Retirement System.

The pension board unanimously accepted Kalwarski's report, but only after the confrontation between Aguirre and Preovolos. The actuary found that the system continued to run a deficit -- he pegged it at \$1.39 billion in the fiscal year that ended June 30 -- but its slide in recent years has been halted.

Jeers and laughs from members of the city's employee unions punctuated Aguirre's and Preovolos' exchange. Many workers are furious with Aguirre because of his attempts to have recent benefit boosts, which he considers illegal, eliminated.

Aguirre has questioned a number of financial and legal consultants at City Council and pension board meetings during the past year using a method that some detractors have said is better suited to a courtroom cross-examination.

Preovolos joined in that chorus yesterday, telling Aguirre that he wanted to "prevent this from turning into a trial." He instructed Aguirre to seek his answers about Kalwarski's qualifications from public records and asked him to submit written queries for the board to evaluate.

The city attorney refused, saying that doing so would prevent him from asking new questions prompted by Kalwarski's responses.

Seeing Preovolos' reluctance, Aguirre appealed to the board's 11 other members -- some of whom he sued last year -- to "sustain or not sustain (the president's) ruling." None came to his aid.

Aguirre told Preovolos he was "censoring the city attorney of San Diego" and called Kalwarski's results "a farce" and "a sham."

Speaking directly to board members, he went on to warn that "you yourself will be evaluated about whether you breached your fiduciary duties" by not requiring certain benefits to be included in the expert's report.

"We kind of pretend what the number is because we know we can't pay the real number," Aguirre said.

That number, \$162 million, is Kalwarski's estimate of what the city should pay the pension system in the fiscal year that begins July 1 to cover benefit obligations to employees.

Aguirre and Councilwoman Donna Frye, who also appeared at the meeting, questioned the variables the expert used to come to that total. The formula adheres strictly to the terms of the 2004 legal settlement that ended the city's practice of underfunding the pension, which was first approved in 1996.

But that deal, Aguirre and Frye said, does not account for a variety of other expenses, including benefits owed to employees because of an earlier legal settlement and a bonus check offered to retirees when the system is deemed to have surplus earnings.

At the board's request, Kalwarski mentioned those elements in a separate section of his report, and noted that they

were not factored into his calculations.

Though Mayor Jerry Sanders plans to hire another actuary to review Kalwarski's work, he said he has "a certain measure of confidence" in the expert's results. The mayor, speaking at an afternoon news conference, also showed some impatience with Aguirre for continuing to press the issue of the \$162 million contribution.

Aguirre has publicly questioned the total since Kalwarski revealed the number two months ago.

"At some point we've got to move on," Sanders said. "I know some people like a crisis, but I simply don't want to manage that way."

Kalwarski confined his analysis to San Diego's portion of the pension system. Though city employees make up the bulk of the fund, it also serves two other agencies, the San Diego Unified Port District and San Diego County Regional Airport Authority.

That portion of his study will be available next month.

Pension system officials are tentatively set to report Kalwarski's results to the City Council at a budget hearing at 9 a.m. Wednesday. He had planned to be at Tuesday's council meeting, but a conflict forced him to reschedule.

Frye wants to question the actuary before the council completes its review of Sanders' proposed \$3 billion budget on May 30.

The city has faced one setback after another since a former pension board member warned the council in 2002 that underfunding the pension while granting employees higher benefits could lead San Diego into financial ruin.

More than three years later, the city continues to suffer through the legal and financial consequences of the deal, which contributed to a pension deficit that Kalwarski estimates has stabilized after several years of rapid growth.

Credit: STAFF WRITER

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

---

#### **Abstract (Document Summary)**

---

The pension board unanimously accepted [Gene Kalwarski]'s report, but only after the confrontation between [Michael Aguirre] and [Peter Preovolos]. The actuary found that the system continued to run a deficit -- he pegged it at \$1.39 billion in the fiscal year that ended June 30 -- but its slide in recent years has been halted.

Preovolos joined in that chorus yesterday, telling Aguirre that he wanted to "prevent this from turning into a trial." He instructed Aguirre to seek his answers about Kalwarski's qualifications from public records and asked him to submit written queries for the board to evaluate.

2 PICS; 1. San Diego City Attorney Michael Aguirre questioned the San Diego pension board yesterday about the credentials of the board's actuary. 2. San Diego pension board President Peter Preovolos refused to allow the city attorney to seek answers from actuary Gene Kalwarski during yesterday's meeting. (Ed. S); Credit: 1,2. John Gastaldo / Union-Tribune photos

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

San Diego's Pension Crisis

## Council panel questions actuary on pension gap

**By Craig Gustafson**  
UNION-TRIBUNE STAFF WRITER

June 15, 2006

As San Diego officials work to reduce a \$1.43 billion pension deficit, debate continues over how much the city should pay each year to close the gap.

The pension system has asked for and will receive \$162 million for fiscal 2007, but two officials – City Attorney Michael Aguirre and Councilwoman Donna Frye – and some civic activists argue that sum does little to lower the deficit and continues to push the burden onto taxpayers.

The pension payment issue bubbled up at times in budget hearings this year, but it took center stage yesterday as the City Council's Budget and Finance Committee asked questions of the actuary who calculated the figure.

Gene Kalwarski of Cheiron Inc. in Virginia defended the method he used to calculate the \$162 million payment to cover retiree obligations and said several pension systems use it.

“It is a method that has taken systems from poorly funded status to fully funded status. We can argue it endlessly, but it is a commonly used method,” he said.

Kalwarski said the payment fulfills the requirements of a legal settlement to stop underfunding the pension system. He said he is staking his firm's reputation that the payment meets governmental accounting standards and will not do further damage to the system.

Pressed by Frye on whether the city should pay more than the \$162 million, Kalwarski wouldn't advise against that.

“Don't think of this as an absolute number,” he said. “If you want to pay more, pay more.”

Kalwarski declined to answer questions from Aguirre based on advice from a pension system lawyer. Aguirre is scheduled to depose Kalwarski on June 30 in a case over the legality of benefits granted retirees in 1996 and 2002.

Aguirre didn't press the issue, but he sparred with the committee's chairwoman, Councilwoman Toni Atkins, when she tried to stop him from clarifying a question a councilman asked the actuary.

“I know you want to restrict the conversation today . . . and the people of San Diego apparently are not going to have a chance to really find out what's going on, Ms. Atkins, and that appears to be the game plan,” Aguirre said.

Atkins dismissed the criticism, saying she simply wanted to hold most of the questions until Kalwarski finished his presentation.

The meeting also marked the first appearance by the city's actuary, Joseph Esuchanko, who Mayor Jerry Sanders hired to analyze the pension system's figures. His contract is not to exceed \$210,000.

Aguirre lauded the hiring of the actuary. "Our goal is to make sure people never again cook our books," he said.

The city's fiscal health has been in question since January 2004, when San Diego officials acknowledged errors and omissions in bond disclosures dating to 1996, triggering federal investigations. Most of the problems are tied to the pension debt.

---

■Craig Gustafson: (619) 293-1884; [craig.gustafson@uniontrib.com](mailto:craig.gustafson@uniontrib.com)

**Find this article at:**

<http://www.signonsandiego.com/news/metro/pension/20060615-9999-1m15pension.html>

☐ Check the box to include the list of links referenced in the article.

© Copyright 2007 Union-Tribune Publishing Co. ? A Copley Newspaper Site

# Exhibit 37

## Payment span set on pension debt

[R,E,S,F Edition]

The San Diego Union - Tribune - San Diego, Calif.

Author: Jennifer Vigil

Date: Mar 17, 2007

Section: LOCAL

Text Word Count: 712

---

### Document Text

---

SAN DIEGO -- Mayor Jerry Sanders scored another political victory yesterday when San Diego's pension board, to retire the system's \$1 billion debt, adopted a payment schedule that is firmly in line with a plan he issued last year.

The city would have 20 years to retire the liability, with contingencies allowing supplemental payments to be made, if needed, to prevent the deficit from growing. The city had taken the opposite approach in recent years, making lower-than-required payments, while the fund fell further and further behind.

To establish the plan, however, the board had to ignore the terms of a measure that voters approved two years ago, calling for the city's pension debt to be paid off in 15 years.

After passage of Proposition G, legal experts, including former state Attorney General Bill Lockyer, said setting such a payment schedule is the responsibility of those who oversee a pension plan, not of voters. An attorney for the system, Harvey Leiderman, agreed yesterday.

Thomas Hebrank, a pension board member, called the measure "unenforceable," and said he and his colleagues "have complete absolute authority" to set the period in which the city is to pay off the deficit.

The pension board approved the 20-year time frame on a 9-3 vote, with three representatives of employee unions dissenting following the addition of a requirement to offset costs from benefit increases on a tighter schedule.

"What this tells San Diegans is we're paying off the debt, starting with this payment," Sanders said hours later, after a news conference to announce another financial development -- the completion of an oft-delayed but crucial audit.

San Diego has been struggling for five years with the monetary, legal and political fallout from its handling of the pension system.

In 1996, with the booming stock market in mind, officials granted benefit boosts, then began shorting the annual amount paid to the pension system in an effort to make budget.

Six years later, the underfunding plan was renewed, although market returns had fallen off sharply. By 2005, the pension system's funded ratio -- a measure of assets versus liabilities -- had plummeted to 66 percent, and the deficit had ballooned to at least \$1.43 billion.

Only this year, after embracing a new calculation method and again enjoying a period of substantial investment gains, has the debt been trimmed to \$1 billion, while the funding ratio has risen to 80 percent.

That improvement has come at a hefty cost. Officials entered into a legal agreement to begin ramping up payments in 2004; since then, the city has pumped more than \$550 million into the system, but only after slashing jobs and service levels for residents.

The board's discussion yesterday focused largely on insider pension-speak, but most of the themes that have dominated City Hall in the past two years surfaced.

Sanders again saw one of his policy proposals approved with little opposition; City Attorney Michael Aguirre again threatened to sue the pension system; and city employees again were left angered by a pension decision.

Sanders' long-term financial outlook, released in November, considered the possibility of augmenting the city's annual payment to the fund, should the pension system not agree to shorten the 26-year period that was in place to eliminate the \$1 billion deficit.

Although the debt is daunting, any attempt to pay it off in a shorter time span requires millions to be added to the annual payment, which has a direct impact on what officials can provide for in the city's budget.

For instance, in the coming fiscal year, beginning July 1, the city is required to contribute \$138 million to the pension fund. The mayor anticipates injecting up to \$25 million more, but if the 15- year timetable had been approved, the amount could have been driven still higher in future years.

Hebrank called the 20-year span a "very fiscally responsible plan" that avoids more hardship, but Aguirre objected to leaving Proposition G behind, telling board members they "have a legal obligation to follow it." The pension board also approved plans to retire future liabilities on varying schedules, including gains and losses from investment experience, which can be paid off in 15 years, and those attributable to new benefits, which must be covered in five years.

Credit: STAFF WRITER

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

---

**Abstract** (Document Summary)

Mayor Jerry Sanders scored another political victory yesterday when San Diego's pension board, to retire the system's \$1 billion debt, adopted a payment schedule that is firmly in line with a plan he issued last year.

Sanders again saw one of his policy proposals approved with little opposition; City Attorney Michael Aguirre again threatened to sue the pension system; and city employees again were left angered by a pension decision.

[Thomas Hebrank] called the 20-year span a "very fiscally responsible plan" that avoids more hardship, but Aguirre objected to leaving Proposition G behind, telling board members they "have a legal obligation to follow it." The pension board also approved plans to retire future liabilities on varying schedules, including gains and losses from investment experience, which can be paid off in 15 years, and those attributable to new benefits, which must be covered in five years.

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.



# Exhibit 38



City of San Diego

**COUNCIL PRESIDENT SCOTT PETERS  
DISTRICT ONE  
M E M O R A N D U M**

**DATE:** August 2, 2007  
**TO:** Honorable Mayor Sanders  
**FROM:** Council President Scott Peters  
**SUBJECT:** 2004 Comprehensive Annual Financial Reports

A handwritten signature in dark ink, appearing to read "Scott Peters", written over the "FROM:" line.

---

Thank you for your and your staff's continuous work on getting the City's past due Comprehensive Annual Financial Reports ("CAFR") completed. As I mentioned during my comments at the July 24, 2007, City Council meeting, I feel strongly that additional disclosures should be considered for the FY 2004 CAFR and future CAFRs.

The following statements represent my own personal understanding of events and activities relevant to the financial markets. If you disagree with the content of any of these statements, I ask that you please advise me of that disagreement in writing. If you agree that these statements are accurate, I ask that you include them in the CAFR so that the financial markets can be fully informed. I do not want the City or its staff to again be accused in the future of not making full and accurate statements about the City's financial situation to the financial markets.

**1. Actions taken on behalf of the City to address Pension Liability – Page 112**

While the dollar figure might change from year to year depending on factors including the number of City employees, please note that the \$17.4 million dollars the City gained through labor concessions from the employees is a recurring annual revenue stream. See also my more extensive comments on this labor negotiation, below.

Please clarify that the \$100 million secured through the securitization of the future tobacco revenue was in compliance with the FY 2006 Memoranda of Understanding

("MOUs") between the City and several employee unions. While it was consistent with the later McGuigan settlement agreement, the securitization did not result from – and not "pursuant to" that court action.

## **2. Investigations into Potential Illegal Acts – Page 124**

There have been significant events in the San Diego District Attorney's action against five former City employees and SDCERS. There has been argument before the Supreme Court of California and the Court of Appeal in the actions and important decisions could be issued in the very near future. Please ensure that this section is updated as the case continues to progress and that the significance of any legal rulings is explained.

## **3. San Diego City Employees Retirement System v. San Diego City Attorney Michael Aguirre and City of San Diego - P. 130**

Please note that the City Council has not decided whether to appeal the December 14, 2006 court ruling.

## **4. Additional Disclosure Items**

The activities of the SEC, Kroll and many pension problems are explained in extensive and appropriate detail. However, many of the policy responses the City has made in response to the SEC and Kroll and the progress the City has achieved are completely omitted or offered in such summary form that their significance is not conveyed. The entities that deal with the City in the financial markets – lenders, underwriters, bond insurers and investors – need to have this information. These significant actions require disclosure so that the CAFR, and any future bond issuances that will incorporate or rely on the CAFR, is accurate and not misleading. The following extensive actions should be explained and addressed in the CAFR.

### **Pension Reform Committee**

In light of growing public concern surrounding pension funding levels, the Mayor and City Council established a Pension Reform Committee of seven citizens with relevant backgrounds in September 2003, and asked the Committee to make recommendations to the council to improve the retirement system's health. In September 2004, the Committee delivered its report (available at <http://www.sandiego.gov/pensionreform/index.shtml>, with 17 recommendations. As of 2007, most of the 17 recommendations have been adopted; following is the current status of each recommendation.

Adopted Recommendations:

- Recommendations 2 and 3 were to amend the Charter to change certain amortization rates used to calculate the UAAL. The City Council placed these on the ballot in 2004; voters adopted the changes. (See discussion of Proposition G, below.)
- Recommendation 4 was that the City's annual contributions to the retirement plan include normal cost, UAAL amortization including interest, and an amount equal to the estimated contingent liability for that year. As part of his five-year budget plan of December 2006, Mayor Sanders has proposed payments beyond the actuarially required contribution ("ARC") and Council approved the Mayor's proposal as part of the FY08 budget.
- Recommendation 5 was that retiree health care benefits no longer be funded via the retirement plan. Before FY 2005, the City paid for retiree health care benefits out of Retirement System assets. The City Council ended this practice on February 1, 2005, so that in FY 2005, \$7.9 million was paid from Retirement System assets and the balance from City funds. Beginning in FY 2006, all health care payments made were from City funds, with no contribution from retirement funds.
- Recommendation 10 was to eliminate programs for new employees allowing Deferred Retirement Option Plan ("DROP")<sup>1</sup> and purchase of service credits, except where federally protected. This was accomplished as part of labor negotiations in 2005 (see discussion below).
- Recommendation 17 sought assurance that employee/employer contributions to the cost of retirement benefits were substantially equal. SDCERS has given this assurance.

Recommendations partially adopted, under consideration or in process:

- Recommendation 11 was to establish a separate trust or accounting for retiree health care liability. The Chief Financial Officer is currently planning to ask the City Council and SDCERS to establish such a retiree health care liability trust fund.
- Recommendations 12 and 13 sought amortization of unfunded liability for retiree health care benefits with no negative amortization. The Mayor and City Council have agreed to this in advance of the new

---

<sup>1</sup> Certain city employees who meet age and service requirements for retirement may participate in the DROP program. DROP allows an employee to retire, but to remain on the payroll for up to an additional five years, with retirement payments earned by the retiree going into a separate DROP account administered by SDCERS, earning interest at the SDCERS assumed rate of return.

requirements of Statement 43 of the Government Accounting Standards Board. The Mayor's five year budget forecast begins to make actuarial calculations of annual health care liabilities; the Mayor plans to make additional funding proposals.

- Recommendation 14 sought re-composition of the SDCERS Board of Administration through a charter amendment, eliminating any employee or retiree representation. The Charter amendment approved by voters in 2004 diminished the representation of employees and retirees, but did not remove them entirely. (See discussion of Proposition H, below).
- Recommendations 15 and 16 suggested improvements to the handling of disability claims. SDCERS has established a disability committee to review all disability issues, and in May 2006, voted to eliminate certain benefits for disability retirees.<sup>2</sup>

Recommendation not adopted:

- Recommendation 1 was to issue between \$200 million and \$600 million in pension obligation bonds. This has not been possible because of lack of access to financial markets; however these are still under consideration depending on financial analysis regarding this action. (See discussion of Pension Funding by the City's Actuarial Consultant at the City Council meeting on April 16, 2007) However, this bond issuance may be called for by the terms of the 2005 labor agreements.
- Recommendations 6-9 (to reduce certain benefits for new employees and to raise retirement ages and reductions in base payroll used to calculate benefits) were not adopted in labor negotiations.

**Settlement of Gleason Litigation**

Since the mid 1990s, the City had been making annual pension contributions that were below actuarially required rates. In early 2003, two retirees sued the City and SDCERS in a class action suit for declaratory relief and breach of fiduciary duties with respect to past underfunding. (Gleason, et al. v. San Diego City Employees' Retirement System, et. al., Case No. GIC803779, SDSC.) As part of the settlement of the litigation, the City:

- Abandoned underfunding agreements known as "Manager's Plan I" (1996) and "Manager's Plan II" (2002);

---

<sup>2</sup> Many of these retirees, including police officers disabled in the course of duty, have protested these cuts at City Council meetings. On September 15, 2006, Mayor Sanders asked the City Attorney for legal advice on this issue, but has yet to receive a response.

- Increased pension contribution for FY 2005 by \$45 million to \$130 million;
- Reset the amortization of the UAAL from the 18<sup>th</sup> year of a 30-year amortization period to a new fixed 30-year period; and
- Agreed to pay the full actuarial contribution for Fiscal Years 2006, 2007 and 2008, based on the new amortization schedule, backed with deeds to City-owned property as security. Note additional payments described above.

### **Proposition F – Mayor Council Form of Government**

From 1931 until 2006, the City of San Diego operated under a City Manager form of government, in which the City was run by a City Manager appointed by a majority of the City Council. Efforts to change the form of government to strong mayor failed at the ballot in 1974, and in the late 1980s and 1990s, when the City Councils refused to put the measures before the voters.

In 2004, however, the City Council placed Proposition F on the ballot on June 29, 2004, and voters approved it on November 2, 2004. The effect of Prop F was to change from a City Manager form of government to a Mayor-Council form of government, in which the Mayor assumes the City's executive duties and the Council performs the legislative duties.

During the deliberations on the transition to a new form of government, and in light of the new emphasis on financial matters, the City Council created a new Committee on Budget and Finance. This was the first time a City Council committee would be focused on the City's budget and fiscal policy issues.

In order to facilitate the reform of the management and processes of city government, the new form of government gave the Mayor the hiring and firing power over the City work force. Prop F authorized the City Council to hire an Independent Budget Analyst ("IBA") to give the council its own fiscal and financial advice to give expert and critical review to information and proposals from the Mayor. This was legally prohibited by the Charter under the previous form of government, pursuant to a ruling in Hubbard v. San Diego, 55 Cal. App. 3d 380 (1976).

The City Council elected a president on November 22, 2005 and approved committee assignments which were approved by the Council. The change in government took effect on January 1, 2006.

### **Formation of Committee on Budget and Finance**

The City Council had operated since the administration of Mayor Pete Wilson through four different five-member committees charged with evaluating proposed programs and legislation and making recommendations to City Council. In 2000, the

Committees were Rules and Intergovernmental Affairs, Public Safety and Neighborhood Services, Natural Resources and Culture, and Land Use and Housing.

### **Proposition G**

The City Council placed Proposition G on the ballot on July 19, 2004, and voters approved it on November 2, 2004. Proposition G:

- Outlawed any further funding agreements between the City and its retirement board; and
- Set a new amortization period for the UAAL of no longer than 15 years and amortization of past service liability associated with new retirement benefit increases at on greater than five years.<sup>3</sup> This fulfilled recommendations numbers 2 and 3 of the Pension Reform Commission.

### **Proposition H**

The City Council placed Proposition H on the ballot on July 19, 2004, and voters approved it on November 2, 2004. Previously, a majority of the retirement board's members had a personal financial interest in the retirement system, as City employees or retirees. Prop H changed the composition of the retirement system board so that a majority of its members would not have any personal interest in the system. The remaining seats were filled as follows: two elected by general members, one elected by fire safety members, one elected by police safety members, one elected by retiree members and one appointed by the City Manager or designee.<sup>4</sup> This partially fulfilled Recommendation 14 of the Pension Reform Committee, which would have eliminated employee representation entirely.

### **Public Disclosure Ordinance**

On October 11, 2004, the City Council unanimously adopted additions and amendments to the San Diego Municipal Code with respect to financial reporting and disclosure, as recommended by Vinson & Elkins, retained by the City earlier that year. These included the establishment of the Disclosure Practices Working Group, "to ensure the compliance of the City (and the City Council, City officers, and staff in the exercise of their official duties) with federal and state securities laws and to promote the highest standards of accuracy in disclosures provided by the City relating to securities issued by the City or by its related entities." San Diego Municipal Code section 22.4104.) It has often been said that these provisions for public disclosures to the markets make San Diego the leader in disclosure protocols.

---

<sup>3</sup> The Attorney General has since opined that the retirement system has plenary authority to set the amortization period for payment of retirement system obligations, suggesting that the Charter's prescribed amortization periods are advisory and not binding.

<sup>4</sup> Pension Reform Commission recommendation 14 would have disqualified any employee or retiree from serving on the board.

### **FY 2006 Labor Negotiations**

In May 2005, the City Council negotiated new labor agreements with two of its four employee labor groups as part of its regular meet and confer process. The City did not reach agreement with the police and fire unions. These negotiations resulted in the following substantial benefits:

- Ended certain benefits for new employees hired on or after July 1, 2005, consistent with recommendation 10 in the Pension Reform Committee Report:
  - Eliminated the 13<sup>th</sup> Check
  - Eliminated Service Purchase Credit options
  - Eliminated Deferred Retirement Option Plan ("DROP")
- Eliminated all benefits except 2.5% at 55 for General and 3.0% at 50 for safety. That means future employees cannot see their benefit formula increased even if they work past age 60.
- Eliminated retiree health benefits for new employees hired on or after July 1, 2005, and agreed to create defined contribution Retiree Medical Trust with understanding that the employees were entitled only to their own contributions and investment earnings on those contributions, but not the benefit itself.
- MEA, Local 127 and Fire Fighters agreed to make an additional 3.0% contribution for their retirement and 3.2% was imposed on police. Local 127 agreed to a reduction of 1.9% of their pay. Together, this created a permanent annual revenue stream of \$17 million, available to leverage against the UAAL:
  - City already paid \$100 million dollars into the pension fund through backfilling the tobacco revenues.
  - Another \$7.5 million remains available annually, which could support another \$100 million reduction.
- Through labor concessions, all participating unions took a pay freeze for the fiscal years 2006 and 2007. This reduced the UAAL by approximately \$150 million, as follows, because the actuary assumes an annual increase of 4.25%:
  - 0% raise in FY 2006: \$75 million
  - 0% raise in FY 2007: \$76 million

### **Approval in Concept of All 121 Recommendations for Financial Reform**

Mayor Sanders identified 121 separate recommendations from the Kroll report for reform and forwarded them to the City Council for adoption in concept. Several of the items could not be finally adopted due to charter change requirements. The next opportunity for changes to the charter is June of 2008. A Charter Review Committee is



currently considering charter changes to allow for implementation of certain Kroll recommendations.

In addition to this statement, the Mayor should include a progress report on the adoption of each of the 121 recommendations.

### **Financial Training for Councilmembers**

In response to the SEC directive, the Council adopted a resolution providing for ongoing and systematic financial and securities training for council members. Thus far, the Council has taken part in Financial Disclosure Training on March 5, 2007 and Financial Statement Overview Training on April 9, 2007 and Debt Issuance and Administration training is scheduled for September 17, 2007. We are unaware of any other city that provides such comprehensive training for its elected officials.

### **End "Waterfall" and Other Municipal Code Changes**

The City of San Diego Pension Reform Committee, Luce Forward LLP, Vinson & Elkins LLP, the previous and current SDCERS' independent actuary, Navigant Consulting and the Kroll have all suggested that SDCERS' use of surplus undistributed earnings to fund contingent benefits -- "the Waterfall" -- may violate the principles of sound actuarial science. As of FY 2008, the City and SDCERS have ended the practice of funding contingent benefits through the waterfall. The City and SDCERS are continuing to work to amend the Municipal Code to reflect the new funding practices and solutions to the other contingent benefits.

### **Formation of Audit Committee**

On January 9, 2007, the Council unanimously voted to approve the formation of an Audit Committee consisting of three councilmembers to provide independent legislation oversight of the City's financial reporting practices and internal controls. The Audit Committee is involved in the hiring of an Internal Auditor and a professional audit consultant to the committee and formation of expert citizen ad hoc committees.

### **Independent Monitor**

On June 7, 2007, the Independent Consultant hired by the City pursuant to the SEC Order, Stanley Keller, issued his initial report. The report includes a summary of actions taken by the City on relevant issues, a description of training, and planned actions by the City. A full copy of the report is not on the City's website and should be made available online for the public. On June 23, 2007, the SEC sent a letter to Mr. Keller asking for more specificity; the Mayor and City Council are expected to address these requests in September.

SHP:tec

cc: City Council  
Andrea Tevlin, Independent Budget Analyst  
Michael Aguirre, City Attorney  
Jay Goldstone, Chief Financial Officer  
Greg Levin  
John McNally, Esq.

# Exhibit 39

**From:** Scott Chadwick  
**To:** Judie Italiano; Nancy Roberts  
**Date:** Thu, Aug 9, 2007 8:07 AM  
**Subject:** Fwd: Urgent Message From MEA

Morning Nancy.

Please see below. This is entirely inappropriate and in violation of Council Policy 300-06. The City had put MEA on notice related to inappropriate use of the City's email system. If this occurs again, the City will be forced to take necessary steps to ensure this does not happen again.

Regards,

Scott C. Chadwick  
Labor Relations Director  
City of San Diego  
1200 Third Avenue, Suite 1316  
San Diego, CA 92101  
MS# 56L  
(619) 236-5587

>>> Steve Ramirez 8/7/2007 12:29:38 PM >>>

>>> "Debbie Quinones" <[dquinones@sdmea.org](mailto:dquinones@sdmea.org)> 08/06/07 11:55 AM >>>  
Please share this message with your e-mail lists.

To Everyone Involved in the Pension Fight

Congratulations to everyone on the tremendous victory we had with Judge Barton's ruling on Friday!

While this victory is sweet there is something important still to do that can help stop the mad man who keeps filing these costly lawsuits.

Our friends on Council have mentioned that it could really help them in reining in the mad man if the newspaper starts getting hundreds of letters calling on the Mayor and the council to put an end to this horrible waste of tax dollars by not allowing the City Attorney to file any more lawsuits aimed at our pension benefits. Mention that the Mayor and Council and the employees have made great strides in addressing this issue and that the City's own actuary (hired by Aguirre) says the CERS system is sound and that there is no risk of the system or the City not being able to meet its pension obligations. Highlight that this was

accomplished in spite of Mike Aguirre's expensive litigation and constant inference. That it happened because City Employees paid more and the City Council insisted on making its full payments to the retirement system in spite of budget shortfalls. Suggest that the Mayor should instruct Aguirre to stop wasting tax payer dollars on litigation the City cannot win - and instead should work with the council. The Mayor and employees need to continue to address the problem in a cooperative way.

I know for many of you this task will turn your stomach - but the council members who I spoke with feel we have an opportunity to get a different dialogue started in the press - to move away from pointing the finger at the greedy employees and their unions - to ask citizens to write in suggesting that the mayor get Mike Aguirre off the expensive litigation track and on the road to real solutions to the City's many problems.

Many of you have been great about writing letters and pointing out what a horrible attorney Mike Aguirre is - and now I am asking you to take a different approach and see what we can accomplish- get some of the people you know who have not written in before to write letters to the editor and to the Mayor and Council along with you - - it can't hurt!

This is the first constructive conversation with council on this issue that we have had in a long time - and I think it will go along way towards building back our relationship with our City decision makers.

Thanks, in advance, for your help on this project - together we can win this battle!

Please write that letter today - before Aguirre talks the Mayor in to letting him file a new lawsuit.

CC: Jay Goldstone; labor relations; Lisa Briggs; Rick Reynolds

# Exhibit 40



# **San Diego City Attorney MICHAEL J. AGUIRRE**

## **MEDIA ADVISORY**

**FOR IMMEDIATE RELEASE: April 12, 2007**

**Contact: Maria Velasquez, Communications Director: (619) 235-5725 [mvelasquez@sanidiego.gov](mailto:mvelasquez@sanidiego.gov)**

### **CITY ATTORNEY RESPONDS TO CITY COUNCIL PRESIDENT'S ACTION TO SUPPRESS PUBLIC'S RIGHT TO KNOW ABOUT PENSION ISSUES**

City Attorney Michael Aguirre briefed the news media this afternoon about a letter he has sent to Council President Scott Peters regarding the effort by Peters to prevent the City Attorney or his Deputy City Attorneys from asking direct questions of the San Diego City Employees' Retirement System's actuary, Gene Kalwarski, at the City Council meeting on Monday, April 16, at 2 p.m., agenda item #202.

The City Attorney also forwarded his letter to the U.S. Securities & Exchange Commission, advising them of the Council President's action.

In his letter to Peters, the City Attorney said, "the Council President has no legal authority to accept such a condition and, in so doing, waive the right of the City Council to receive, and the citizens of San Diego to hear, the legal advice and counsel of the City Attorney."

On April 11, 2007 Peters sent a letter to SDCERS' Retirement Administrator David B. Wescoe, agreeing to SDCERS' request that the City Attorney and his staff be denied the opportunity to ask questions of the SDCERS actuary.

###



**COUNCIL PRESIDENT  
SCOTT H. PETERS**

CITY OF SAN DIEGO

April 11, 2007

David B. Wescoe  
Retirement Administrator  
San Diego City Employee's Retirement System  
401 B Street, Suite 400  
San Diego, CA 92101

Dear Mr. Wescoe:

Thank you for agreeing to have the San Diego City Employees' Retirement System ("SDCERS") actuary, Mr. Gene Kalwarski of Cheiron, appear before the City Council on April 16, 2007, along with Mr. Joseph Esuchanko, the City's actuarial consultant.

Due to current and threatened litigation between the City and SDCERS, you have asked, as a condition of Cheiron's appearance, for an assurance that no SDCERS representative, including your actuary, will be called upon to answer questions from the City Attorney or any of his deputies at the Council meeting. In order that we may hear from the actuary, I will agree to this condition. Of course, any member of the City staff or City Attorney's office may wish to provide you or Mr. Kalwarski with written questions in advance of the meeting. You or your actuary may choose whether or not to answer these questions.

I look forward to an informative discussion of actuarial numbers on April 16, 2007.

Sincerely,

Scott Peters

SHP:bbk

cc: Honorable Mayor and City Councilmembers  
Honorable City Attorney Michael Aguirre  
Jay Goldstone, CFO  
Andrea Tevlin, IBA





OFFICE OF  
**THE CITY ATTORNEY**  
CITY OF SAN DIEGO

**MICHAEL J. AGUIRRE**

CITY ATTORNEY

CIVIL DIVISION  
1200 THIRD AVENUE, SUITE 1620  
SAN DIEGO, CALIFORNIA 92101-4178  
TELEPHONE (619) 236-6220  
FAX (619) 236-7215

April 12, 2007

Honorable Council President Scott H. Peters  
202 C Street, MS 10A  
San Diego, California 92101

Dear Council President Peters:

I am in receipt of your letter to David Wescoe, dated April 11, 2007, in which you purport to assure Mr. Wescoe that no representative of SDCERS or Cheiron, the SDCERS actuary, will be subject to questioning by the City Attorney or any Deputy City Attorney at the April 16, 2007 City Council meeting. Neither you nor any member of the City Council has the authority to prohibit the City Attorney from discharging his duties as chief legal advisor of the City under Charter Section 40. Asking questions of individuals engaged in City business before the City Council clearly falls within the scope of those duties.

While I appreciate Mr. Wescoe's concerns regarding ongoing litigation, this excuses neither his appearance nor the appearance of the SDCERS actuary before the Council. Moreover, it is highly inappropriate for Mr. Wescoe to attempt to set conditions upon the appearance of any employee or agent of SDCERS at a meeting of the City Council for any reason. Further, the Council President has no legal authority to accept such a condition and, in so doing, waive the right of the City Council to receive, and the citizens of San Diego to hear, the legal advice and counsel of the City Attorney. Should Mr. Wescoe or any other representative of SDCERS or Cheiron find it necessary, they are welcome to appear before the Council with legal representation and seek advice in the event that they are asked a question that could have a deleterious effect on the legal position of SDCERS vis a vis the City.

In no event is the ongoing litigation between SDCERS and the City a shield behind which SDCERS can hide to avoid appearing before the Council or answering questions from the City Attorney. Please inform Mr. Wescoe that his appearance before the Council shall be unconditional. I look forward to a productive meeting on April 16.

Sincerely,



MICHAEL J. AGUIRRE, City Attorney

MJA:jdf

cc: Honorable Mayor and City Councilmembers  
Jay Goldstone, CFO  
Andrea Tevlin, IBA  
David Wescoe